S. HRG. 101-499

CORPORATE TAKEOVER LEGISLATION

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 1244

TO AMEND THE SECURITIES AND EXCHANGE ACT OF 1934 WITH RESPECT TO TENDER OFFERS, AND FOR OTHER PURPOSES

S. 1658

TO AMEND THE SECURITES AND EXCHANGE ACT OF 1934 TO IMPOSE ADDITIONAL DISCLOSURE AND FAIRNESS REQUIREMENTS WITH RESPECT TO CORPORATE TENDER OFFERS

S. 1794

TO AMEND THE SECURITIES AND EXCHANGE ACT OF 1934 WITH RESPECT TO MERGERS AND CORPORATE TENDER OFFERS, AND FOR OTHER PURPOSES

NOVEMBER 20, 1989

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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CORPORATE TAKEOVER LEGISLATION

MONDAY, NOVEMBER 20, 1989

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON SECURITIES,
Washington, DC.

The subcommittee met at 2 p.m. in room SD-538 of the Dirksen Senate Office Building, Senator Christopher J. Dodd (chairman of the subcommittee) presiding.

Present: Senators Dodd, Heinz, Kassebaum, and Pressler.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. The committee will come to order.

Today the Subcommittee on Securities is meeting for the purpose of considering legislation that has been drafted by a number of our colleagues dealing with corporate takeovers. I want to again apologize, particularly to our colleague, Senator Metzenbaum, who is here, and Senator Sanford, as well as others, for the inconvenience they may have been caused last week through timing problems. Since they have both been here some time, they appreciate and understand how these things can occur, and I am grateful to them for being available today for this hearing.

Senator METZENBAUM. You could make up for it, Mr. Chairman, by having them turn down the television lights.

Senator DODD. You like those, do you? Just to make you feel more at home.

Anyway, I would like to welcome all of you here to the hearing this afternoon. Senator Heinz and I have scheduled this hearing to provide an opportunity for our colleagues who have sponsored takeover legislation to testify on their bills and to provide a record for consideration of these measures in the next session of the 101st Congress.

There is obviously a deep interest in addressing shareholders' rights and the corporate restructuring process in this country, and it is my intention and I know the intention of my colleague Senator Heinz to work with our colleagues in the next session to see if it is at all possible to reach a consensus in these crucial areas that have such a broad impact on U.S. capital markets.

Since the late 1970's, the United States has experienced an explosive growth from corporate takeovers and mergers. Recent reports show that the value of all corporate mergers has grown from $67.3 billion in 1981 to $226.6 billion in 1988.

This dramatic growth in takeovers and leveraged buyouts has raised concerns in a number of areas.

One main concern is the impact of these transactions on the strength and productivity of the individual companies affected, as well as the economy as a whole.

A second concern, addressed largely in the proposals before us today, is the impact of takeover and leveraged buyouts on shareholders and shareholder rights.

Today we will hear from our fellow Banking Committee members, Senators Shelby and Sanford—and Senators Metzenbaum and Specter, on their proposals to reform the corporate takeover process and shareholder rights. Senator Kassebaum and Senator Graham have also introduced legislation that addresses important issues, but due to scheduling conflicts they will be unable to attend the hearing. But we will certainly accept their testimony and include it as part of the record.

Therefore, let me give a special thanks again to our colleagues who are with us here today, and I look forward to hearing from you about your proposals and of course working with you in the coming months to see if we can move some legislative product.

[Copies of the introduced bills follow:]

II

101ST CONGRESS
1ST SESSION

S. 1244

To amend the Securities Exchange Act of 1934 with respect to tender offers, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 22 (legislative day, JANUARY 3), 1989

Mr. METZENBAUM (for himself and Mr. ARMSTRONG) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Securities Exchange Act of 1934 with respect to tender offers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Corporate Takeover Reform Act of 1989".

SEC. 2. CHANGE OF 13(d) THRESHOLD AND 10-DAY WINDOW.

Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended by striking "5 per centum of such class shall, within ten days" and inserting "4 percent of such class shall, within one day".

SEC. 3. WAITING PERIOD.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended—

(1) by striking subsection (d)(2) and inserting the following:

"(2) Any person making a tender offer or request of invitation for tenders shall hold such offer, request, or invitation open for a period of at least 60 days from the date on which such offer, request, or invitation is first published or sent or given to security holders, except that this paragraph shall not apply to such an offer, invitation, or request by the issuer for the class of securities being sought if such offer, invitation, or request is not made in anticipation of or response to another person's offer, request, or invitation for securities of the same class."; and

(2) by adding at the end the following:

"(h)(1) For the purpose of subsections (d) and (f) of this section, when 2 or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, voting, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person'.

"(2) For the purpose of this section, the term 'voting equity security' means any equity security of the issuer that entitles the holder thereof to vote generally in an election of directors of the issuer.".

SEC. 4. GREENMAIL.

Section 13(e) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(e)) is amended by adding at the end the following:

"(4) It shall be unlawful for an issuer of any class of equity security described in section 14(d)(1) of this title to acquire, directly or indirectly, any of its securities from any person who is the beneficial owner of more than 3 percent of the class of the securities to be acquired unless such acquisition has been approved by the vote of a majority of the outstanding voting securities of the issuer (excluding the shares to be acquired), or acquisition is pursuant to a tender offer, or request or invitation for tenders, to all holders of securities of such class. A vote under this paragraph shall be conducted in accordance with rules and regulations in effect under section 14(a)(2). The Commission shall by rule, regulation, or by order, on application, conditionally or unconditionally, exempt any person, security, or transaction from any or all of the provisions of this paragraph as it determines to be necessary or appropriate and consistent with the public interest, the protection of investors, and the purposes of this paragraph.".

SEC. 5. POISON PILLS.

Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) is amended by adding at the end the following new subsection:

"(m)(1) It shall be unlawful for an issuer of any class of equity security which is registered pursuant to this section, or any equity security of an insurance company which would be required to be so registered except for the exemption contained in subsection (g)(2)(G), or any equity security issued by a closed-end investment company registered under the Investment Act of 1940, to issue, grant, declare, or establish any rights, including voting rights, of securities holders of the issuer with respect to any security or asset of the issuer or any other person, where the exercisability of such right is conditioned on the acquisition of securities of the issuer by a person other than the issuer, unless the establishment of such rights has been approved by a majority of the aggregate outstanding voting securities of the issuer. A vote under this subsection shall be conducted in accordance with rules and regulations in effect under section 14(a)(2). If such rights were established prior to the effective date of rules and regulations under the preceding sentence, such rights shall remain in effect after the close of the 3-year period beginning on the date of enactment of this subsection only if such rights are approved by the shareholders pursuant to this subsection prior to the close of such period.

"(2) The Commission may, by rule, regulation, or by order, upon application, conditionally or unconditionally, exempt any person, security, or transaction, or class thereof

from any or all the provisions of this subsection to the extent it determines such exemption is necessary or appropriate in the public interest and for the protection of investors and consistent with the purposes and policy fairly intended by this subsection.".

SEC. 6. GOLDEN PARACHUTES.

Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) is amended by adding at the end thereof the following new subsections:

"(n)(1) In the case of any class of equity security which is registered pursuant to this section, or any equity security of an insurance company which would be required to be so registered except for the exemption contained in subsection (g)(2)(G), or any equity security issued by a closed-end investment company registered under the Investment Act of 1940, it shall be unlawful for the issuer of such securities to enter into or amend, directly or indirectly, agreements to increase the current or future compensation of any officer or director in an amount which would constitute an 'excess parachute payment' as defined in section 280G(b)(1) of the Internal Revenue Code of 1986, contingent upon a change of control of the issuer by stock or asset acquisition, unless such agreements have been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer. A vote under this subsection shall be conducted in

accordance with rules and regulations in effect under section 14(a)(2). If any such agreement was entered into prior to the effective date of rules and regulations under the preceding sentence, such agreement shall remain in effect after the close of the 3-year period beginning on the date of enactment of this subsection only if such agreement is approved by the shareholders pursuant to this subsection prior to the close of such period.

"(2) The Commission may, by rule, regulation, or by order, upon application, conditionally or unconditionally—

"(A) exempt any person, security, or transaction from any or all of the provisions of this subsection as it determines to be necessary or appropriate and consistent with the public interest or the protection of investors, and

"(B) provide exemptions, subject to such terms and conditions as may be prescribed therein, from any or all of the provisions of this subsection.

SEC. 7. CONFIDENTIAL PROXY VOTING.

Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended—

(1) by inserting "(1)" after "(a)"; and

(2) by adding at the end the following:

"(2)(A) Unless the Commission prescribes rules and regulations providing for an alternative tc confidential proxy

voting as described in paragraph (3), the rules and regulations prescribed by the Commission under paragraph (1) shall require confidentiality in the granting and voting of proxies, consents, and authorizations, and shall provide for the announcement of results of a vote following tabulation by an independent third party certified in accordance with such rules and regulations. Nothing in this paragraph authorizes any person to withhold information from the Commission or from any other duly authorized agency of Federal or State government.

"(B) The Commission shall prescribe any rules and regulations required by subparagraph (A) within 1 year after the date of enactment of this paragraph.

"(3)(A) In lieu of the rules and regulations described in paragraph (2), the Commission may prescribe rules and regulations which provide for an alternative to confidential proxy voting, if such alternative will assure—

"(i) the integrity of the proxy voting procedures,

"(ii) fairness to shareholders,

"(iii) unimpeded exercise of shareholder voting franchise,

"(iv) insulation from improper influence to a degree that meets or exceeds the protection afforded by confidential proxy voting, and

"(v) announcement of results of a vote following tabulation by an independent third party certified in accordance with such rules and regulations.

"(B) In promulgating rules and regulations under this paragraph the Commission shall—

"(i) consult with the Secretary of Labor, and

"(ii) hold public hearings, inviting the participation of all interested parties, including individual shareholders, securities issuers, institutional investors, and securities firms.

"(C) The Commission shall prescribe any rules and regulations required by subparagraph (A) not later than 11 months after the date of enactment of this paragraph.".

SEC. 8. INCREASED ACCESS TO PROXY STATEMENTS FOR SHAREHOLDERS.

Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended by adding at the end the following:

"(4) There shall be included in any proxy and other solicitation materials (as defined in the rules promulgated under paragraph (1) by the Commission) sent by any issuer to its shareholders pursuant to this subsection, descriptions and other statements of or with respect to any issue to be presented by the issuer for decision by the shareholders (including descriptions and statements or with respect to any candi-

dates for election as directors), and any other proposals and descriptions and statements pertaining to such proposals, that are submitted by persons or groups of persons, if such person or group is the beneficial owner of voting equity securities of such issuer representing not less than 3 percent of the voting power of such issuers' securities. Such descriptions, other statements, and other proposals shall receive equal space, coverage, and treatment as is received by the issues and positions on such issues of (or the candidates nominated by) the board of directors or management of such issuer, and shall be subject to such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.".

SEC. 9. DAMAGES FOR SECURITIES FRAUD.

Section 10 of the Securities Exchange Act of 1934 (15 U.S.C. 78j) is amended—

(1) by redesignating paragraphs (a) and (b) as paragraphs (1) and (2);

(2) by inserting "(a)" after "SEC. 10."; and

(3) by adding at the end the following:

"(b) Notwithstanding section 28(a) of this title, in an action for damages arising from a violation of subsection (a)(2) of this section, a person may recover an amount up to twice the actual damages suffered if the trier of fact finds that

the violation demonstrated wanton disregard for the rights of such person.".

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II

101ST CONGRESS
1ST SESSION

S. 1658

To amend the Securities and Exchange Act of 1934 to impose additional disclosure and fairness requirements with respect to corporate tender offers.

IN THE SENATE OF THE UNITED STATES

SEPTEMBER 21 (legislative day, SEPTEMBER 18), 1989

Mr. SHELBY introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Securities and Exchange Act of 1934 to impose additional disclosure and fairness requirements with respect to corporate tender offers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Investor Equality Act of 1989".

SEC. 2. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) under the laws as they exist, investors have not always received timely, adequate, or sufficient information with respect to accumulations of securities in

the market and with respect to conduct involved in tender offers;

(2) investors have at times been denied fair treatment in the course of tender offers;

(3) the integrity of securities markets and the confidence of the public in them, which are essential to the economic welfare of the country, have been threatened by the conduct of parties in tender offers; and

(4) certain individuals and entities have sought to precipitate, intensify, and prolong speculation in connection with acquisitions or proposed acquisitions of issuers of securities to the detriment of such issuers and their shareholders and the public—

(A) by engaging in acts and practices which circumvent the equal treatment of all shareholders; and

(B) by failing to disclose the nature and extent of their activities, including actions taken to circumvent the purposes and requirements of the law.

(b) PURPOSES.—Therefore, in order to protect investors and the public interest, the purposes of this Act are to reduce the opportunities for abuse under the present Federal securities laws and to expand the protective mechanisms of such Federal securities laws.

SEC. 3. 10-DAY WINDOW.

(a) Section 13(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)) is amended—

(1) in paragraph (1), by striking "within ten days after such acquisition," and inserting "within 5 days after such acquisition, make a public announcement in the manner and containing the information prescribed in paragraph (7) of this subsection and";

(2) in paragraph (3), by inserting "voting" between "acquiring," and "holding", and by inserting "(whether or not organized)" between "group" and "for"; and

(3) by inserting after paragraph (6) the following new paragraphs:

"(7) The public announcement referred to in paragraph (1) of this subsection shall be disseminated to one or more nationally recognized financial news services, or otherwise as the Commission may prescribe by rule or regulation, and shall contain the following information and such additional information as the Commission may by rule or regulation prescribe, as necessary or appropriate in the public interest, for the protection of investors, and to carry out the purposes of this paragraph:

"(A) The identity of the person making such announcement.

"(B) Whether the purpose of the person filing such statement or amendment (i) is to acquire or change the control of the issuer, or (ii) is solely for investment, without any purpose or effect of changing or acquiring the control of the issuer.

"(C) The number of shares of such security which are beneficially owned by such person and the nature of the beneficial ownership of such securities.

"(D) In the case of an amendment, any other information necessary to summarize the material changes to be reported in such amendment.

"(8) The Commission may adopt such rules, regulations, and orders as may be necessary or appropriate in the public interest or for the protection of investors—

"(A) to implement the provisions of this subsection;

"(B) to define any term used in this subsection; or

"(C) to prescribe means reasonably designed to prevent any person from evading or circumventing the provisions of this subsection.".

(b) Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended by adding at the end the following:

"Any person required to send and file such a statement may not acquire or agree to acquire, directly or indirectly, the

beneficial ownership of any additional amount of such equity securities after the transaction that required such person to send and file such statement until after such statement has been filed with the Commission and a public announcement has been made in the manner and containing the information prescribed in paragraph (7) of this subsection.".

(c) Section 13(g)(3) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(g)(3)) is amended—

(1) by inserting "(whether or not organized)" between "group" and "for"; and

(2) by inserting "voting" between "acquiring" and "holding".

SEC. 4. CIVIL LIABILITY.

(a) Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended—

(1) by inserting "(1)" after "(d)"; and

(2) by adding at the end the following:

"(2)(A) Whenever it shall appear to the Commission that any person (as defined in section 13(d)(3) of this title) has violated, or aided and abetted a violation of, any provision of subsection (d), (f), or (g) of section 13 of this title, or the rules and regulations thereunder, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by such person. The amount of such penalty shall be determined

based on the facts and circumstances but shall not exceed 3 percent per day of the value of the securities that are the subject of the violation for each day during the period that the violation continues, but in no event shall the penalty exceed 50 percent of the aggregate value of such securities. The value of the securities for purposes of this paragraph shall be measured by the highest market value of the securities during the period of the violation and shall include all securities required to be reported by such person. Any such penalty shall be payable into the Treasury of the United States. No such action may be brought more than 3 years after the date of the violation on which it is based. If a person upon whom such a penalty is imposed fails to pay such penalty within the time prescribed in the court's order, the Commission shall refer the matter to the Attorney General who shall bring an action in the appropriate United States district court to recover the penalty. The district court shall also have the authority to impose such equitable remedies as the court deems proper to carry out the purposes of subsection (d), (f), or (g) of this section and the rules and regulations thereunder, as the case may be, including an order enjoining any person violating any such provision from voting securities acquired in connection with such violation, an order to compel divestiture of such securities, or an order enjoining

the making of any tender offer or other effort to acquire control for such period of time as the court may order.

"(B) The actions authorized by this paragraph may be brought in addition to any other actions that the Commission or the Attorney General are entitled to bring, and any other remedies that are otherwise available in such actions. For purposes of section 27 of this title, actions under this paragraph shall be actions to enforce a liability or a duty created by this title. The Commission may by rule, regulation, or order exempt any class of persons or transactions from the provisions of this paragraph.".

(b) Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)) is amended by adding at the end thereof the following:

"(3) In addition to such other authority as the Commission may otherwise have under this title, the authority vested in the Commission pursuant to section 21(d)(1) of this title to institute an action under this title for violations of sections 7, 13(d), 13(f), and 13(g) of this title, or the rules and regulations thereunder, shall include the authority to seek such equitable relief as the court deems proper to carry out the purposes of those sections, including (A) an order enjoining any person violating any such provision of those sections or rules and regulations from voting securities acquired in connection with such violation, (B) an order to compel divestiture of such

securities, or (C) an order enjoining the making of any tender offer or other effort to acquire or influence control of the issuer of such securities for such period of time as the court may order.".

SEC. 5. TENDER OFFERS.

(a) Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by striking out the section heading and inserting in lieu thereof the following:

"PROXIES AND TENDER OFFERS".

(b) Section 14(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(d)) is amended—

(1) by striking out paragraph (2);

(2) by redesignating paragraphs (3) through (8) as paragraphs (6) through (11), respectively; and

(3) by inserting after paragraph (1) the following:

"(2) Any person who makes a tender offer for, or a request or invitation for tenders of, shares of any class of any such equity security shall hold such offer, request, or invitation open for a period of at least 35 business days from the date on which such offer, request, or invitation is first published, sent, or given to security holders, or such longer period as the Commission may, by rule or regulation, prescribe.

"(3) If, during the 35-day period described in paragraph (2), a qualified employee stock ownership plan notifies the offeror, the issuer, or the Commission, of the plan's intent to

acquire additional securities of the issuer on terms which are substantially equivalent to other offers, paragraph (2) shall be applied by substituting '95' for '35'.

"(4)(A) For purposes of this subsection, the term 'person' shall include 2 or more persons who act together pursuant to an express or implied agreement or understanding for the purpose of acquiring, holding, or disposing, of securities of an issuer, or influencing the management or policies of an issuer, such as by acting (A) as a partnership, limited partnership, syndicate, or other group whether or not formally organized, (B) pursuant to an arrangement or understanding to indemnify against loss or to hold harmless, or (C) otherwise.

"(B) For purposes of this subsection, the term 'qualified employee stock ownership plan' means an employee stock ownership plan defined in section 4975(e)(7) of the Internal Revenue Code of 1986 which—

"(i) is sponsored by the issuer (or a member of the controlled group) of the equity securities to which the request or invitation for tenders described in paragraph (1) is made,

"(ii) meets the requirements of section 410(b) of the Internal Revenue Code of 1986, and

"(iii) owns securities of the issuer representing at least 10 percent of the outstanding voting securities (of

the issuer) on the day on which the 35-day period begins to run and has held such 10 percent for a period beginning at least 6 months before such 35-day period begins to run.

"(5)(A) It shall be unlawful for any person by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to acquire, or agree to acquire, directly or indirectly, any shares of any class of any equity security described in paragraph (1) of this subsection if such person is, or after consummation of such acquisition would become, directly or indirectly, the beneficial owner of more than 25 percent of such class unless such acquisition is made pursuant to a tender offer, or a request or invitation for tenders.

"(B) The provisions of this paragraph shall not apply to any acquisition or proposed acquisition of a security if—

"(i) the acquisition of such security, together with all other acquisitions by the same person of securities of the same class during the preceding 12 months, would not exceed 2 percent of that class;

"(ii) a block of 10 percent or more of the outstanding shares is acquired and such shares were held by the seller for at least 2 years prior to the sale;

"(iii) such acquisition is from 1 family member to another;

"(iv) such acquisition is made by a person who owned more than 50 percent of the outstanding shares prior to such purchase; or

"(v) the Commission, by rule or regulation, or by order, has exempted such acquisition from the provisions of this subsection as it determines to be necessary or appropriate and consistent with the public interest, the protection of investors, and the purposes of this paragraph.".

(c) Section 14(d)(9) of such Act, as redesignated by subsection (a), is amended by striking out "paragraph (7)" in the last sentence and inserting in lieu thereof "paragraph (10)".

SEC. 6. GREENMAIL.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following new subsection:

"(h)(1) For the purpose of discouraging manipulative tender offer practices, any profit realized by any person from any disposition, directly or indirectly, to an issuer of securities described in subsection (d)(1), of equity securities of such issuer, shall inure to and be recoverable by such issuer, if such person was the beneficial owner, at the time of such disposition, of more than 3 percent of the class of securities so disposed of, and had held any or all of such securities for less than 1 year prior to the disposition thereof, unless (A)

such disposition has been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer, or (B) the same offer is made available to all shareholders.

"(2) The Commission shall, by rule, regulation, or by order upon application, conditionally or unconditionally exempt any person, security, or transaction from any or all of the provisions of this paragraph as it determines to be necessary or appropriate and consistent with the public interest, the protection of investors, and the purposes of this paragraph.

"(3) An action to recover profit under this subsection may be brought in any court of competent jurisdiction by the issuer or by the owner of any equity security of the issuer in the name and on behalf of such issuer if the issuer fails or refuses to bring such action within 60 days after request or shall fail diligently to prosecute the same thereafter. No such action shall be brought more than 2 years after the date such profit was realized. This subsection does not apply to any transaction where the profits realized are, or may be, recovered under section 16(d) of this title.".

SEC. 7. ACTIONS BY ISSUERS.

Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) is amended by adding at the end the following new subsections:

"(m)(1) It shall be unlawful for the issuer of any class of equity security which is registered pursuant to this section, or any equity security of an insurance company which would be required to be so registered except for the exemption contained in subsection (g)(2)(G), or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, to enter into or amend, directly or indirectly, agreements to increase the current or future compensation of any officer or director in an amount which would constitute an 'excess parachute payment', as defined in section 280G(b)(1) of the Internal Revenue Code of 1986, contingent upon a change of control of the issuer by stock or asset acquisition, unless such agreements have been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer. If any such agreement was entered into prior to enactment of this subsection, such agreement shall remain in effect after the close of the 2-year period beginning on the date of enactment of this subsection only if such agreement is approved by the shareholders pursuant to this subsection prior to the close of such period.

"(2) The Commission may, by rule, regulation, or by order, upon application, conditionally or unconditionally—

"(A) exempt any person, security, or transaction from any or all of the provisions of this subsection as it

determines to be necessary or appropriate and consistent with the public interest or the protection of investors, and

"(B) provide exemptions, subject to such terms and conditions as may be prescribed therein, from any or all of the provisions of paragraph (1).

"(n)(1) It shall be unlawful for an issuer of any class of any equity security described in subsection (m)(1) to issue, grant, declare or establish any rights, including voting rights, of securities holders of the issuer with respect to any security or asset of the issuer or any other person, where the exercisability of such right is conditioned on the acquisition of securities of the issuer by a person other than the issuer, unless the establishment of such rights has been approved by a majority of the aggregate outstanding voting securities of the issuer. If such rights were adopted prior to enactment of this subsection, such rights shall remain in effect after the close of the 2-year period beginning on the date of enactment of this subsection only if such rights are approved by the shareholders pursuant to this subsection prior to the close of such period.

"(2) The Commission may, by rule, regulation, or by order, upon application, conditionally or unconditionally, exempt any person, security, or transaction, or class thereof from any or all of the provisions of this paragraph to the

extent it determines such exemption is necessary or appropriate in the public interest and for the protection of investors and consistent with the purposes and policy fairly intended by this paragraph.".

SEC. 8. CONFIDENTIAL PROXY VOTING.

Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended—

(1) by inserting "(1)" after "(a)"; and

(2) by adding at the end the following:

"(2)(A) Unless the Commission prescribes rules and regulations providing for an alternative to confidential proxy voting as described in paragraph (3), the rules and regulations prescribed by the Commission under paragraph (1) shall require confidentiality in the granting and voting of proxies, consents, and authorizations, and shall provide for the announcement of results of a vote following tabulation by an independent third party certified in accordance with such rules and regulations. Nothing in this paragraph authorizes any person to withhold information from the Commission or from any other duly authorized agency of Federal or State government.

"(B) The Commission shall prescribe any rules and regulations required by subparagraph (A) within 1 year after the date of enactment of this paragraph.

"(3)(A) In lieu of the rules and regulations described in paragraph (2), the Commission may prescribe rules and regulations which provide for an alternative to confidential proxy voting, if such alternative will assure—

"(i) the integrity of the proxy voting process,

"(ii) fairness to shareholders,

"(iii) unimpeded exercise of shareholder voting franchise,

"(iv) insulation from improper influence to a degree that meets or exceeds the protection afforded by confidential proxy voting, and

"(v) announcement of results of a vote following tabulation by an independent third party certified in accordance with such rules and regulations.

"(B) In promulgating rules and regulations under this paragraph the Commission shall—

"(i) consult with the Secretary of the Department of Labor, and

"(ii) hold public hearings, inviting the participation of all interested parties, including individual shareholders, securities issuers, institutional investors, and securities firms.

"(C) The Commission shall prescribe any rules and regulations required by subparagraph (A) not later than 11 months after the date of enactment of this paragraph.".

SEC. 9. INCREASED ACCESS TO PROXY STATEMENTS FOR SHAREHOLDERS.

Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended by adding at the end thereof the following:

"(4) There shall be included in any proxy and other solicitation materials (as defined in the rules promulgated under paragraph (1) by the Commission) sent by any issuer to its shareholders pursuant to this subsection, descriptions and other statements of or with respect to any issue to be presented by the issuer for decision by the shareholders (including descriptions and statements or with respect to any candidates for election as directors), and any other proposals and descriptions and statements pertaining to such proposals, that are submitted by a person or groups of persons, if such person or group is the beneficial owner of voting equity securities of such issuer representing not less than 10 percent of the voting power of such issuer's securities. Such descriptions, other statements and other proposals shall receive equal space, coverage, and treatment as is received by the issues and positions on such issues of (or the candidates nomi-

nated by) the board of directors or management of such issuer, and shall be subject to such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.".

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II

101ST CONGRESS
1ST SESSION

S. 1794

To amend the Securities Exchange Act of 1934 with respect to mergers and corporate tender offers, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 25 (legislative day, SEPTEMBER 18), 1989

Mr. SPECTER introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To amend the Securities Exchange Act of 1934 with respect to mergers and corporate tender offers, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CREEPING TAKEOVERS.

Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(d)(1)) is amended by striking out "within ten days after such acquisition" and inserting in lieu thereof "cease to acquire additional shares of such class until the expiration of 24 hours after the statement required by this subsection has been filed, and shall, not later than 48 hours after such acquisition,".

SEC. 2. UNIFORM VOTING RIGHTS.

(a) REGISTRATION.—Section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) is amended by adding at the end thereof the following:

"(m)(1) A security may not be registered under subsection (b) of this section on a national securities exchange if such security is a common stock that is part of a class of securities of the issuer which is nonvoting or which carries disproportionate voting rights, unless the issuance of such security has been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer.

"(2) Paragraph (1) shall not prohibit the continued registration of a common stock that is part of a class which carries disproportionate voting rights if such common stock (A) was admitted to listed trading on a national securities exchange prior to the date of enactment of this subsection, (B) remains continuously listed on such exchange, and (C) within 2 years after the date of enactment of this subsection, meets the minimum standards for original listing in effect on the date of enactment of this subsection with respect to disproportionate voting rights of the national securities exchange which had the third highest trading volume in 1986.

"(3) For purposes of this subsection, a class of common stock carries a disproportionate voting right if the beneficial owner of a share of any class of common stock of the issuer is

entitled to cast more or less than one vote on the basis of such share on any matter requiring the vote of the common stock of the issuer.".

(b) AUTOMATED QUOTATION SYSTEM.—Section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3) is amended by adding at the end thereof the following:

"(i)(1) A security may not be quoted on an automated quotation system operated by a national securities association registered pursuant to this section if such security is a common stock that is part of a class of securities of the issuer which is nonvoting or which carries disproportionate voting rights, unless the issuance of such security has been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer.

"(2) Paragraph (1) shall not prohibit the continued quotation of a common stock that is part of a class which carries disproportionate voting rights if such common stock (A) was prior to the date of enactment of this subsection quoted on an automated quotation system operated by a national securities association, and (B) within 2 years of the date of enactment of this subsection, meets the minimum standards for original listing in effect on the date of enactment of this subsection with respect to disproportionate voting rights of the national securities exchange which had the third highest trading volume in 1986.

"(3) For purposes of this subsection, a class of common stock carries a disproportionate voting right if the beneficial owner of a share of any class of common stock of the issuer is entitled to cast more or less than one vote on the basis of such share on any matter requiring the vote of the common stock of the issuer.".

SEC. 3. TWO-TIERED TAKEOVERS.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following:

"(i)(1) Unless the laws of the State of incorporation of the issuer provide otherwise, it shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursuant to section 12, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G), or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 20 percent of such class unless—

"(A) such person is the issuer of that security; or

"(B) the offer is a cash offer for all outstanding shares of the class.

"(2) When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for purposes of this subsection.

"(3) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

"(4) The Commission shall, by rules and regulations or upon application of an interested person, exempt from the prohibition contained in paragraph (1) any class of securities of any issuer upon such terms and conditions and for such period as it deems necessary or appropriate if it finds that such action is not inconsistent with the public interest or the protection of investors.".

SEC. 4. JUNK BONDS.

Section 14(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(d)) is amended by redesignating paragraphs (5) through (8) as paragraphs (6) through (9), respectively,

and inserting after paragraph (4) the following new paragraph:

"(5)(A) Any person making a tender offer or request or invitation for tenders which is either (A) part of a management leveraged buyout (as such term is defined in subsection (a)(2)(B) of this section), or (B) financed by noninvestment grade securities shall hold such offer, request, or invitation open for at least 90 days from the date on which the statement required by paragraph (1) of this subsection with respect to such offer, request, or invitation is filed with the Commission. In the event such offer, request, or invitation is part of a leveraged buyout which has been approved by the issuer, during such 90-day period, the issuer shall, to the extent legally permitted, provide full access to its books and records, subject only to reasonable assurance of the confidentiality thereof, to any other person who makes a bona fide proposal to acquire substantially all of the assets, or all of the capital stock entitled to vote generally in the election of directors, of the issuer.

"(B) For purposes of this paragraph, such offer, request, or invitation shall be considered to be financed by noninvestment grade securities if—

"(i) any part of the financing thereof shall not have been committed at the time of the commencement of such offer, request, or invitation, or

"(ii) any part of the financing thereof shall be provided from any source other than (I) cash on hand, (II) bank financing for which commitments have been received at or prior to the commencement of such offer, request, or invitation, or (III) the proceeds of the sale of common stock or securities having a rating of at least 'BBB' issued by Standard and Poor Corporation or 'Baa' issued by Moody's Investor Service, Inc. or having an equivalent rating issued by a nationally recognized bond rating organization, for which firm underwriting commitments have been received at or prior to the commencement of such offer, request or invitation.".

SEC. 5. LEVERAGED BUYOUTS BY MANAGEMENT.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended—

(1) by inserting "(1)" after "(a)"; and

(2) by adding at the end thereof the following:

"(2)(A) In the case of any solicitation of proxies or consents pursuant to this subsection for the approval of a management leveraged buyout not subject to subsection (d)(5) of this section, such management leveraged buyout shall not be consummated prior to 90 days after all information required by such rules and regulations of the Commission with respect thereto shall have been provided to the shareholders of the

issuer. Prior to the consummation of such management leveraged buyout, the issuer shall, to the extent legally permitted, provide full access to its books and records, subject only to reasonable assurance of the confidentiality thereof, to any other person who makes a bona fide proposal to acquire substantially all of the assets, or all of the capital stock entitled to vote generally in the election of directors, of the issuer.

"(B) For purposes of this section, 'management leveraged buyout' means an acquisition of shares of an issuer in connection with which one or more members of the management of such issuer will own, directly or indirectly, within 5 years of the consummation of such transaction, at least 5 percent of the equity capital of the surviving or continuing business.".

SEC. 6. MARGIN REQUIREMENTS.

Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78g) is amended by adding at the end the following:

"(h) An issuer of securities or any shareholder of securities, purchased or carried in violation of this section or the rules or regulations thereunder, may bring an action in any court of competent jurisdiction to recover actual damages sustained by such issuer or shareholder, and the cost of the suit, including attorney fees, and to seek such equitable relief as the court deems proper to carry out the purposes of this section.".

SEC. 7. GREENMAIL.

Section 14 of the Securities Exchange Act of 1934 (15 U.S.C. 78n) is amended by adding at the end thereof the following new subsection:

"(h)(1) For the purpose of discouraging manipulative tender offer practices, any profit realized by any person from any disposition, directly or indirectly, to an issuer of securities described in subsection (d)(1), of equity securities of such issuer, shall inure to and be recoverable by such issuer, if such person was the beneficial owner, at the time of such disposition, of more than 3 percent of the class of securities so disposed of, and had held any or all of such securities for less than one year prior to the disposition thereof, unless (A) such disposition has been approved by the affirmative vote of a majority of the aggregate outstanding voting securities of the issuer, or (B) the same offer is made available to all shareholders.

"(2) The Commission shall, by rule, regulation, or by order upon application, conditionally or unconditionally exempt any person, security, or transaction from any or all of the provisions of this paragraph as it determines to be necessary or appropriate and consistent with the public interest, the protection of investors, and the purposes of this paragraph.

"(3) An action to recover profit under this subsection may be brought in any court of competent jurisdiction by the

issuer or by the owner of any equity security of the issuer in the name and on behalf of such issuer if the issuer fails or refuses to bring such action within 60 days after request or shall fail diligently to prosecute the same thereafter. No such action shall be brought more than 2 years after the date such profit was realized. This subsection does not apply to any transaction where the profits realized are, or may be, recovered under section 16(b) of this title.".

SEC. 8. INCREASED PENALTIES FOR INSIDER TRADING, PERJURY, AND OBSTRUCTION OF JUSTICE.

Section 32 of the Securities Exchange Act of 1934 (15 U.S.C. 78ff) is amended by adding at the end thereof the following:

"(d) Any person who willfully violates any provision of this title or the rules and regulations thereunder by communicating or by purchasing or selling a security while in possession of material nonpublic information, in a transaction on or through the facilities of a national securities exchange or from or through a broker or dealer, but not including transactions which are part of a public offering by an issuer of securities other than standardized options, shall upon conviction be fined not more than $1,000,000, or imprisoned not more than 10 years, or both.

"(e) Any person who willfully in the course of an investigation of a violation of this title relating to the purchasing

or selling of a security while in the possession of material nonpublic information violates section 1505, 1510, 1621, or 1622 of title 18, United States Code, shall upon conviction be imprisoned for one year, which shall be in addition to and served consecutively to any other term of imprisonment for the violation.".

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Senator DODD. Senator Heinz.

Senator HEINZ. Mr. Chairman, I would ask unanimous consent that my full statement be a part of the record.

The CHAIRMAN. Without objection.

Senator HEINZ. I just want to join Chairman Dodd in expressing my appreciation to our witnesses here today, my colleague from Pennsylvania, Senator Specter, and our neighboring colleague from Ohio, Senator Metzenbaum, and of course Senator Sanford for, as the Chairman pointed out, your willingness to accommodate the committee to reschedule your testimony to this better occasion for us.

I salute all of you on taking an interest in this issue. It is obviously a complex one. You might say it is even volatile because on this committee when we bring up the issues, no sooner does somebody propose to close the 10-day window than somebody else comes up with a proposal to absolutely forbid any States from having any role in this issue.

I would suspect if one thinks that the stock markets on look like a roller-coaster, the levels of opinion that are generated in this committee on this subject is not far behind. I expect we will get a diversity of points of view here today. I look forward to not only hearing them but asking our witnesses to elaborate on some of, I am sure, the very important points they will make.

So, Mr. Chairman, again I commend you in holding this hearing and look forward to it very much.

[The complete prepared statement of Senator Heinz follows:]

STATEMENT OF SENATOR JOHN HEINZ

Senator HEINZ. Mr. Chairman, I join you in welcoming our colleagues to this Securities Subcommittee hearing on takeover legislation. Those who think they understand the meaning of volatility by watching our stock markets can gain new insights by watching the Congress debate issues relating to corporate takeovers and leveraged buyouts. I hope that the Securities Subcommittee will become an affair and orderly marketplace for a constructive exchange of ideas and insights relating to these important issues.

Corporate takeovers, leveraged buyouts and corporate restructurings involve a broad spectrum of critical issues relating to:

The competitiveness of our Nation's businesses.

The corporate governance process.

The relationships among, and the responsibilities, of officers, directors and shareholders.

The institutionalization of corporate shareholders.

The capital formation process and the relative roles of debt and equity in corporate finance.

The delicate balance of both Federal and State law in corporate affairs and shareholder communications.

These are complex issues that do not lend themselves to simple solutions. They require careful consideration to avoid using a broad brush stroke where surgical precision is warranted. These issues deserve our attention. Therefore, I am pleased to have the opportunity to listen to the views of collegues who have spent considerable time in formulating proposals that address these issues.

Senator DODD. Thank you, Senator Heinz.

Senator Sanford, do you have any opening?

Senator SANFORD. I won't have any opening statement, Mr. Chairman.

Senator DODD. Senator Metzenbaum, we welcome you here today. I would point out, just interestingly, last week when we had the delay we were debating the market reform legislation, and one of the amendments that was offered was an amendment that had to do with preemption of State commercial laws, and it was intriguing in a sense because a package of amendments that were waiting for us in that bill had to do with preemption of State law as well, whether or not we would preempt State law in the whole area of corporate governance.

It was just an interesting dichotomy at the time.

We welcome you here and are prepared to hear your statement.

STATEMENT OF SENATOR HOWARD M. METZENBAUM, MEMBER, U.S. SENATE, FROM THE STATE OF OHIO

Senator METZENBAUM. Thank you, Mr. Chairman, Senator Heinz, Senator Sanford. I am happy to be here. My colleague, Senator Specter.

I came out of the business world before I came to the Senate, and I knew something about corporate activities, some fair amount with respect to corporate mergers, but in the intervening years the takeovers that have occurred in the industry and the defensive procedures as well as offensive procedures have truly been startling, and it is because of that Senator Armstrong and I some months ago introduced the so-called Corporate Takeover Reform Act of 1989.

Now, the bill contains a number of provisions, which I will not explain at length because I don't think it behooves me to do so at this hearing, but I think many of these problems need to be corrected and they arise out of the current takeover environment. Many of these provisions I have introduced before. The legislation actually has three parts.

The first is aimed at reforming the tender offer process.

The second part would increase fairness to shareholders by protecting them against abusive defensive tactics because in some instances the corporate executives have been more concerned about their own position than they have been about the shareholders.

And the third part of the bill amends the securities laws with respect to civil liability arising out of certain violations by providing for double damages in addition to actual damages in some cases.

Now, I am frank to say to you the legislation is not a cure-all, but it would go a long way toward alleviating some of the ills associated with tender offers and security fraud. Let me describe some of the provisions in very brief detail.

The S. 1244 would reduce the 10 day notice period to one day because in that 10 day period lots of things have happened.

In addition, I believe it is also appropriate to reduce the threshold at which notice must be given to 4 percent rather than the current 5 percent.

These stricter requirements will provide shareholders with much earlier notice, one day, of large scale stock purchases that often

precede a takeover and a resulting sharp escalation in stock prices. I think the shareholders are entitled to it. There is no reason to have a 10 day window.

The second provision would have to do with the waiting period. Now, that section of the bill would give additional time for shareholders to respond to a tender offer from the current 20 business days to 60 calendar days. Frankly, the 20 day period is too short. They don't know what is going on. They are scared. Should they do it, shouldn't they do it? And it would give the shareholders an adequate time to carefully consider what are some oftentimes very complex investment decisions, and it would also force potential bidders to make hasty decisions without adequate—excuse me, it would force the recipients to make hasty decisions without adequate analysis. To the extent other potential bids are therefore discouraged, shareholders actually may be deprived of more favorable bids that would allow them to realize the best value for their stock.

And let's not kid ourselves. The corporate world relies upon the shareholders, and without those shareholders you don't have a viable market, and too often the ones who are in the know, the pension managers, the ones who handle the big blocks, they know what is going on but Joe Blow from some small city in Connecticut or Ohio or Pennsylvania or North Carolina, whatever the case may be, is totally without resources, call their local broker, their local broker doesn't know enough about what is going on, and they say I think you should take it or why don't you sit back a while, and they are uninformed. Sixty days would give them much more protection.

Now, one of the things that has been really very distasteful—and I remember it specifically in connection with the Goodyear—attempted Goodyear takeover, when there was a move being made on the company by that English banker whose name slips me for the second, and they didn't want to participate in greenmail. But they did wind up taking greenmail to get rid of him.

And S. 1244 would prohibit the payment of greenmail unless approved by a majority of the outstanding voting securities of the issuer.

Too often a raider making a play for a company becomes rich when the corporation is forced to buy its own stock at a premium. It is blackmail, but we have sort of made it more dignified by calling it greenmail. If you want to get me off your back, buy me out at a premium. And the rest of the shareholders—all the rest of the shareholders wind up subsidizing the buyout of the greenmailer.

It is unfair to the other shareholders who, unlike the raider, are not paid a premium for their shares, and the companies that pay greenmail are frequently far weaker because they are saddled with debt after coming up with the cash necessary to pay it, and Goodyear was the one specifically that was involved.

I might say for the record that the name of the gentleman I couldn't remember was Sir James Goldsmith.

I have long been concerned about another aspect of this whole matter of takeovers, and that is when the corporations have attempted to protect themselves. It really wasn't the corporations protecting themselves. It was the executive officers who were concerned about their position. So they developed a thing called poison

pills. The Chair and members of the committee are familiar with the term.

The poison pill tends to protect entrenched management and deny stockholders the opportunity to gain the full value of their shares in takeover situations because it significantly raises the cost of acquiring a company.

This bill would make it unlawful for a company to establish poison pills without the approval of a majority of the shareholders.

Then there is the issue of golden parachutes. You heard more of that subject a year or so ago than you hear it today because I think many companies have already put them in place. But golden parachutes are often so large that they act as barriers to successful takeovers even of entrenched and inefficient management.

S. 1244 would not ban golden parachutes, but would require that any such arrangement would have to be approved by the majority of the aggregate outstanding voting securities of the issuer.

So in instance after instance we say give the decisionmaking to the shareholders.

Then there is the issue of confidential proxy voting. Corporate elections are the only elections in America where the incumbents prepare the ballot, with only their issues and their candidates on it, send the ballots to the voters, and then collect and count the ballots. It is worse even than in some of the dictatorships of the world. But the corporate world does it. They state the issues, they send out the ballots, they count the ballots, they collect the ballots, and too often the corporate managers use their control of the proxy voting mechanisms, including their knowledge of how shareholders vote, to call the voters back and coerce the votes of shareholders and influence the proxy voting. It is wrong, it is unfair.

Confidential voting and independent tabulation of the results are an essential element not only of political democracy but of corporate democracy as well, and it is also essential to takeover reform. Without a fair and effective proxy process, legislative improvements in the tender offer process that depend on shareholder approval would be meaningless.

We would then provide for increased access with respect to the proxy statements for shareholders. We would require that any proxy materials sent by the issuer to its shareholders must include a fair treatment of any other proposal submitted by anyone who is owner of at least 3 percent of the voting power of the company securities.

I think last year this committee set a 10 percent threshold, but I think that is too high to result in the inclusion of many meaningful and relevant minority proposals.

And then we have a proposal having to do with increased civil liability for securities fraud. I won't take up the time of the committee to spell that out, but suffice it to say that it would provide for an additional double damages over and above the actual damages for civil securities fraud.

Mr. Chairman, I would hope that this issue that has been around for a long time, that the Banking Committee has looked at and thought about, hassled with over a period of years, would be a first priority in the coming Congress. I don't think there is any secret about it that there is going to be some upheaval at some point in

the whole corporate world with respect to major changes in the economy. I think we in the Congress ought to be prepared for it by having adequate legislation at least to deal in part with some of it. It won't be a cure-all, but it would be a major step forward in protecting the rights of the shareholders.

And I thank you, Mr. Chairman.

[The complete prepared statement of Senator Metzenbaum follows:]

U.S. Senator Howard M.
METZENBAUM
of Ohio

Committees:
Judiciary
Labor and Human Resources
Energy and Natural Resources
Select Committee on Intelligence

Chairmanships:
Subcommittee on Antitrust
Subcommittee on Labor
Subcommittee on Energy
Regulation and Conservation

STATEMENT OF SENATOR METZENBAUM

BEFORE THE SENATE BANKING COMMITTEE

SUBCOMMITTEE ON SECURITIES

ON S. 1244

THE CORPORATE TAKEOVER REFORM ACT OF 1989

NOVEMBER 16, 1989

MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO TESTIFY THIS AFTERNOON ON THE "CORPORATE TAKEOVER REFORM ACT OF 1989," A BILL I INTRODUCED WITH SENATOR ARMSTRONG EARLIER THIS YEAR.

THIS BILL CONTAINS A NUMBER OF PROVISIONS WHICH I BELIEVE ARE MUCH NEEDED TO CORRECT SERIOUS PROBLEMS ARISING OUT OF THE CURRENT TAKEOVER ENVIRONMENT. MANY OF THESE PROVISIONS I HAVE INTRODUCED BEFORE. THE LEGISLATION HAS THREE MAIN PARTS. THE FIRST IS AIMED AT

REFORMING THE TENDER OFFER PROCESS BY REQUIRING EARLIER NOTICE OF STOCK PURCHASES, AND CHANGING THE WAITING PERIOD FOR SHAREHOLDERS TO RESPOND TO TENDER OFFERS. I INTRODUCED THESE PROVISIONS LAST CONGRESS AS PART OF S. 678.

THE SECOND PART WOULD INCREASE FAIRNESS TO SHAREHOLDERS BY PROTECTING THEM AGAINST ABUSIVE DEFENSIVE TACTICS. IT WOULD PROTECT SHAREHOLDERS BY LIMITING THE USE OF GREENMAIL, POISON PILLS, AND GOLDEN PARACHUTES, AND PROVIDING FOR CONFIDENTIAL PROXY VOTING. I CO-SPONSORED THESE PROVISIONS WITH SENATOR ARMSTRONG AND OTHER SENATE COLLEAGUES AS AMENDMENTS TO S. 1323 AT THE END OF THE LAST SESSION.

THE THIRD PART OF THE BILL AMENDS THE SECURITIES LAWS WITH RESPECT TO CIVIL LIABILITY ARISING OUT OF CERTAIN VIOLATIONS BY PROVIDING FOR DOUBLE DAMAGES IN SOME CASES.

THIS LEGISLATION IS NOT A CURE-ALL, BUT IT WILL GO A LONG WAY TOWARDS ALLEVIATING SOME OF THE ILLS ASSOCIATED WITH TENDER OFFERS AND SECURITIES FRAUD. LET ME DESCRIBE SOME OF THESE PROVISIONS IN DETAIL.

CHANGE OF 13(d) THRESHOLD AND 10-DAY WINDOW

UNDER CURRENT LAW, A PERSON ACQUIRING 5 PERCENT OF A CLASS OF STOCK MUST FILE NOTICE WITH THE SEC AND

THE PUBLIC. THE PURCHASER IS ALLOWED A 10-DAY WINDOW AFTER THE 5 PERCENT THRESHOLD IS REACHED BEFORE NOTICE IS REQUIRED. DURING THIS PERIOD, SUBSTANTIAL ADDITIONAL SHARES CAN BE PURCHASED. THIS DELAY MEANS THAT SHAREHOLDERS, WHO ARE UNAWARE OF THE INTENTIONS OF THE PERSON OR PERSONS MAKING THE TENDER OFFER, CONTINUE TO TRADE THEIR STOCK AT VALUES FAR BELOW THOSE WHICH WOULD EXIST IF THE INTENTIONS HAD BEEN MADE PUBLIC. S. 1244 WOULD REDUCE THIS 10-DAY PERIOD TO ONE DAY. IN ADDITION, I BELIEVE IT IS ALSO APPROPRIATE TO REDUCE THE THRESHOLD AT WHICH NOTICE MUST BE GIVEN TO 4 PERCENT RATHER THAN 5 PERCENT. THIS STRICTER REQUIREMENT WILL PROVIDE SHAREHOLDERS WITH EARLIER NOTICE OF LARGE SCALE STOCK PURCHASES THAT OFTEN PRECEDE A TAKEOVER AND A RESULTING SHARP ESCALATION IN STOCK PRICES.

WAITING PERIOD

THIS SECTION OF THE BILL EXTENDS THE TIME FOR SHAREHOLDERS TO RESPOND TO A TENDER OFFER FROM THE CURRENT 20 BUSINESS DAYS TO 60 CALENDAR DAYS. UNDER THE CURRENT LAW, A PREMIUM IS PLACED ON SPEED, RATHER THAN RATIONAL, INFORMED DECISIONMAKING. THE PRESENT 20 DAY TIME PERIOD IS TOO SHORT TO ALLOW SHAREHOLDERS THE TIME TO CAREFULLY CONSIDER WHAT ARE OFTEN VERY COMPLEX INVESTMENT DECISIONS AND FORCES POTENTIAL BIDDERS TO

MAKE HASTY DECISIONS WITHOUT ADEQUATE ANALYSIS. TO THE EXTENT OTHER POTENTIAL BIDS ARE THEREFORE DISCOURAGED, SHAREHOLDERS MAY BE DEPRIVED OF MORE FAVORABLE BIDS THAT WOULD ALLOW THEM TO REALIZE THE BEST VALUE FOR THEIR STOCK.

GREENMAIL

S. 1244 WOULD PROHIBIT THE PAYMENT OF GREENMAIL UNLESS APPROVED BY A MAJORITY OF THE OUTSTANDING VOTING SECURITIES OF THE ISSUER. THE TERM "GREENMAIL" REFERS TO THE PURCHASE BY A CORPORATION OF ITS OWN STOCK IN ORDER TO RID ITSELF OF A TAKEOVER ATTEMPT BY A HOSTILE RAIDER. TOO OFTEN A RAIDER MAKING A PLAY FOR A COMPANY BECOMES RICH WHEN A CORPORATION IS FORCED TO BUY ITS OWN STOCK AT A PREMIUM. THIS IS UNFAIR TO OTHER SHAREHOLDERS WHO, UNLIKE THE RAIDER, ARE NOT PAID A PREMIUM FOR THEIR SHARES. THE COMPANIES THAT PAY GREENMAIL ARE FREQUENTLY WEAKER AND SADDLED WITH DEBT AFTER COMING UP WITH THE CASH NECESSARY TO PAY IT. MOREOVER, THE OPPORTUNITY TO WALK AWAY FROM A DEAL WITH A FORTUNE IN GREENMAIL OFFERS AN INDUCEMENT TO RAIDERS TO MAKE PLAYS FOR COMPANIES WHERE THERE IS NO THOUGHT TO GAINING CONTROL OF THE COMPANY, IMPROVING MANAGEMENT, OR MAKING THE COMPANY MORE EFFICIENT. THIS PROVISION IS SUBSTANTIALLY SIMILAR TO ONE RECOMMENDED BY THE

SECURITIES AND EXCHANGE COMMISSION IN 1984.(SEE S. 2784, INTRODUCED IN THE 98TH CONGRESS AT THE REQUEST OF THE COMMISSION, JUNE 20, 1984).

POISON PILLS

I HAVE LONG BEEN CONCERNED ABOUT THE NEGATIVE EFFECTS OF POISON PILLS. THEY TEND TO PROTECT ENTRENCHED MANAGEMENT AND DENY STOCKHOLDERS THE OPPORTUNITY TO GAIN THE FULL VALUE OF THEIR SHARES IN TAKEOVER SITUATIONS BECAUSE THEY SIGNIFICANTLY RAISE THE COST OF ACQUIRING A COMPANY. THESE RIGHTS ARE NOT INTENDED TO ENCOURAGE INVESTMENT IN THE COMPANY OR TO EXPAND SHAREHOLDERS' RIGHTS. THEY ARE SOLELY DESIGNED TO DISCOURAGE A BIDDER FROM ATTEMPTING A TAKEOVER BID AND UNFAIRLY DISCOURAGE LEGITIMATE ATTEMPTS TO CHANGE CORPORATE OWNERSHIP AND SHOULD BE PROHIBITED.

S. 1244 WOULD MAKE IT UNLAWFUL FOR A COMPANY TO ESTABLISH POISON PILLS WITHOUT THE APPROVAL OF A MAJORITY OF SHAREHOLDERS. IT FURTHER REQUIRES THAT ALL POISON PILLS ADOPTED PRIOR TO THE ENACTMENT OF THIS LEGISLATION BE SUBMITTED TO THE SHAREHOLDERS FOR A VOTE WITHIN 3 YEARS. ADDITIONALLY, THE PROVISION GRANTS SOME REGULATORY AUTHORITY FOR EXEMPTIONS TO THE SEC.

GOLDEN PARACHUTES

GOLDEN PARACHUTES, WHICH GUARANTEE A SUBSTANTIAL SEVERENCE PAY TO THOSE WHO LOSE THEIR JOBS AS A RESULT OF A TAKEOVER, ARE UNFAIR TO SHAREHOLDERS FOR A COUPLE OF REASONS. FIRST, THE AMOUNT OF THE SEVERENCE USUALLY IS FAR BEYOND WHAT IS WARRANTED AND THEREFORE WASTES CORPORATE RESOURCES. SECONDLY, THE AMOUNT IS OFTEN SO LARGE THAT IT ACTS AS A BARRIER TO SUCCESSFUL TAKEOVERS EVEN OF ENTRENCHED AND INEFFICIENT MANAGEMENT.

S. 1244 WOULD NOT BAN GOLDEN PARACHUTES, BUT WOULD REQUIRE THAT ANY SUCH ARRANGEMENT BE APPROVED BY A MAJORITY OF THE AGGREGATE OUTSTANDING VOTING SECURITIES OF THE ISSUER (THOSE NOT HELD TO BE INSIDERS). A GOLDEN PARACHUTE IS DEFINED ACCORDING TO THE IRS CODE AS THREE TIMES ANNUAL COMPENSATION.

CONFIDENTIAL PROXY VOTING

THIS PROVISION IS PARTICULARLY IMPORTANT IN LIGHT OF THE OTHER PROVISIONS OF THIS BILL WHICH DEPEND UPON SHAREHOLDER VOTES TO RATIFY WHAT ARE OTHERWISE UNHEALTHY CORPORATE PRACTICES. THIS SECTION HAS ONE SIMPLE PURPOSE-TO PROTECT THE CONFIDENTIALITY AND INTEGRITY OF THE PROXY VOTING PROCESS.

CURRENTLY THE PROXY RULES, AS ESTABLISHED BY THE SEC, REQUIRE DISCLOSURE AND TIMELY DISTRIBUTION OF PROXY MATERIALS, AND PROHIBIT FALSE PROXY STATEMENTS AND FRAUDULENT PROXY SOLICITATIONS. THESE RULES DO NOT HOWEVER PROVIDE THE MOST BASIC PROTECTION OF ALL: CONFIDENTIALITY. CORPORATE ELECTIONS ARE THE ONLY ELECTIONS IN AMERICA WHERE THE INCUMBENTS PREPARE THE BALLOT WITH ONLY THEIR ISSUES AND THEIR CANDIDATES ON IT, SEND THE BALLOTS TO THE VOTERS, AND THEN COLLECT AND COUNT THE BALLOTS. TOO OFTEN THE CORPORATE MANAGERS USE THEIR CONTROL OF THE PROXY VOTING MECHANISM, INCLUDING THEIR KNOWLEDGE OF HOW SHAREHOLDERS VOTE, TO COERCE THE VOTES OF SHAREHOLDERS AND INFLUENCE PROXY VOTING. THIS IS WRONG AND UNFAIR. CONFIDENTIAL VOTING AND INDEPENDENT TABULATION OF THE RESULTS ARE AN ESSENTIAL ELEMENT OF CORPORATE DEMOCRACY. THEY ARE ALSO ESSENTIAL TO TAKEOVER REFORM. WITHOUT A FAIR AND EFFECTIVE PROXY PROCESS, LEGISLATIVE IMPROVEMENTS IN THE TENDER OFFER PROCESS THAT DEPEND ON SHAREHOLDER APPROVAL WILL BE MEANINGLESS.

INCREASED ACCESS TO PROXY STATEMENTS FOR SHAREHOLDERS

IN ADDITION TO ASSURING THE CONFIDENTIALITY OF THE PROXY VOTING PROCESS, I ALSO THINK IT IS IMPORTANT THAT

THE SHAREHOLDERS BE FULLY INFORMED CONCERNING ISSUES WHICH ARE IMPORTANT TO THE VALUE OF THE COMPANY AND THEIR STAKE IN IT. FOR THAT REASON S. 1244 ALSO INCLUDES A PROVISION MODELED AFTER A SIMILAR PROVISION IN S. 1323 LAST SESSION. TOO OFTEN WHAT THE SHAREHOLDERS HEAR ABOUT A TENDER OFFER IS FROM THE BIASED POINT OF VIEW OF MANAGEMENT. THESE SHAREHOLDERS ARE THEREFORE UNLIKELY TO HAVE THE INFORMATION NECESSARY TO INTELLIGENTLY WEIGH THE DECISION PUT BEFORE THEM. IT IS ONLY FAIR THAT THEY HEAR BOTH SIDES OF THE ARGUMENTS BEFORE MAKING THEIR DECISION.

THIS SECTION WOULD REQUIRE THAT ANY PROXY MATERIALS SENT BY THE ISSUER TO ITS SHAREHOLDERS MUST INCLUDE A FAIR TREATMENT OF ANY OTHER PROPOSALS SUBMITTED BY ANYONE WHO IS THE OWNER OF AT LEAST 3 PERCENT OF THE VOTING POWER OF THE COMPANY'S SECURITIES. LAST YEAR'S BANKING COMMITTEE PROPOSAL SET A 10 PERCENT THRESHOLD, BUT I THINK THAT IS TOO HIGH TO RESULT IN THE INCLUSION OF MANY MEANINGFUL AND RELEVANT MINORITY PROPOSALS.

INCREASED CIVIL LIABILITY FOR SECURITIES FRAUD

MULTIPLE DAMAGES ARE NOT AVAILABLE UNDER THE FEDERAL SECURITIES LAWS FOR ORDINARY CIVIL FRAUD. THIS IS SO BECAUSE THE COURTS HAVE INTERPRETED SECTION 28(a)

OF THE SECURITIES EXCHANGE ACT OF 1934, WHICH READS: "NO PERSON...SHALL RECOVER...A TOTAL AMOUNT IN EXCESS OF HIS ACTUAL DAMAGES" IN A SUIT UNDER THE ACT, TO BAR PUNITIVE DAMAGES. THIS LANGUAGE, HOWEVER, IS CLEARLY AIMED AT PREVENTING A DOUBLE RECOVERY UNDER STATE AND FEDERAL LAW RATHER THAN AT PUNITIVE DAMAGES, AS IS MADE CLEAR FROM A READING OF THE REST OF THE STATUTE. THERE IS IN FACT NO GOOD REASON WHY THE TORT OF FRAUD SHOULD BE TREATED ANY DIFFERENTLY WITH RESPECT TO SECURITIES FRAUD. BECAUSE INVESTORS DEFRAUDED IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES ARE LIMITED TO RECOVERING ACTUAL DAMAGES THEY RARELY IF EVER RECOVER THERE ACTUAL LOSSES UNDER THE SECURITIES LAWS. FOR THAT REASON PLAINTIFFS HAVE BEEN ENCOURAGED TO RELY INSTEAD ON THE RICO STATUTES AS A WAY TO BE MADE WHOLE. AS CONGRESS IS CONSIDERING TAKING AWAY THAT AVENUE FOR PLAINTIFFS, IT IS ESSENTIAL THAT THIS PROVISION BE ENACTED IN ORDER TO PROTECT INVESTORS AND INSURE FULL AND ADEQUATE RECOVERIES.

THIS PROVISION WOULD DO JUST THAT. IT AMENDS SECTION 10 OF THE SECURITIES EXCHANGE ACT OF 1934 TO PERMIT RECOVERY OF UP TO TWICE THE ACTUAL DAMAGES SUFFERED AS A RESULT OF THE FRAUD. THIS ADDITIONAL RECOVERY ABOVE ACTUAL DAMAGES WOULD BE ALLOWED ONLY WHERE THE DEFENDANT ACTED IN WANTON DISREGARD FOR THE PLAINTIFF'S RIGHTS. I INTRODUCED A SIMILAR PROVISION AS PART OF S. 657 IN THE LAST CONGRESS.

Senator HEINZ [presiding]. Senator Metzenbaum, thank you very much.

Senator Dodd has stepped out for a moment. He will be back. I am going to call upon each of our Senatorial witnesses in turn in the order on the witness list. Our next witness is a member of the committee, Senator Terry Sanford.

Senator SPECTER. Terry, if you ask yourself questions, will you go back up there and come back and answer them? [Laughter.]

Senator SANFORD. I thought I better keep my seat.

Senator HEINZ. Senator Sanford, we are delighted to have you not only as a witness but, I might add, as a member of this committee, and for the benefit of the recording clerk there was what is called in Italian a sotto voce inquiry made of the Senator from North Carolina by the Senator from Pennsylvania, which was to the effect do you get to go back up there and ask yourself questions after you are done.

The answer is that the Senator can do it any way he wants because in this committee he is the 5,000 pound canary.

Senator SANFORD. I will tell you this. I have always had a lot of questions to ask myself, I must say. [Laughter.]

STATEMENT OF SENATOR TERRY SANFORD, MEMBER, U.S. SENATE, FROM THE STATE OF NORTH CAROLINA

Senator SANFORD. I am not going to burden the witnesses and the Chairman with a full statement. There will be plenty of time for questions of my proposals, and I would ask that my full statement be placed in the record.

The CHAIRMAN. Without objection, your entire statement will appear in the record.

Senator SANFORD. I appreciate the fact that we have an opportunity to start this discussion. I think we have been too tied up for the last two years, first by the banking legislation and then the S&L legislation, to get into this field that I consider extremely important—proposals to reform our takeover and leveraged buyout laws. This is a subject that has concerned me for a long, long time.

Part of my concern stems from watching corporation after corporation in my home state, from R.J. Reynolds to Burlington Industries to Cone Mills to J.P. Stevens to Holly Farms, now possibly to Hardees Foods and Ivey's Department Store and Brown & Williamson Tobacco, go through the trauma and destruction of highly leveraged hostile takeovers and leveraged buyouts.

My concern also stems from having served on a number of corporate boards, one of which successfully withstood a determined effort for a hostile takeover, one of which was taken over in a somewhat double-barreled hostile deal, and a third of which meekly succumbed—in spite of feeling that it wasn't good for the company, as has turned out to be the case—to a more or less hostile takeover.

So I have seen this from a number of points of view, and consequently I have thought about it a great deal. I believe we have seen a fundamental shift away from deals being done for sound financial and business reasons, to deals being done for the fees they can generate.

Senator Metzenbaum himself was engaged in a deal that I know something about some years ago that made good business sense, but now far too high a percentage of the deals are being done for the financial manipulation, pure and simple. The motivation lies most of all in the huge up-front fees for promoters and bankers and lawyers who have no real stake in the long run fatality of the firm.

But in reflecting on how we approach these issues and the experience we had in the last Congress in failing to pass S. 1323, I have come to the conclusion that we need to shift the debate and the focus of our legislation away from our raiders versus entrenched management, whatever that is, fight to the more fundamental problems of encouraging corporate management to manage for the long term and encouraging investors to take a longer term view at the same time that we curb the abuses that have led to excessive volatility in our markets.

We had two hearings last week on America's competitive position, and I was struck by the testimony reflecting on America's competitiveness and the challenges we face. One witness at the hearing, Daniel Burstein, noted that he is often asked what is the number one thing we can do to reverse the current situation?

His answer is "we must bring to an end our malignant focus on short-term interests, short-term rewards, short-term solutions. When you think in long term you begin to realize that however many instant billionaires are created by the speculative stock markets, managers focused on quarter-to-quarter profits, highly leveraged corporate takeovers, and rapid fire mergers and acquisitions, we are witnessing not the competitive restructuring of American industry but a suicidal dismemberment of the very companies, sectors, and industries in which America now has global competitive strengths."

And I agree with that, Mr. Chairman, I will summarize a couple of sections that I intend to put in a bill for introduction early in the next year. First of all, however, I'd like to make the point that I don't know that the problem is so much entrenched management or inefficient management. The companies that I have watched go through these deals lately were all extremely well-run companies, and that is probably why they were takeover targets.

The concept that they are not is a concept that has been promoted without a great deal of verification and evidence.

The great problem with management today is that it is hardly possible for the manager of a corporation to take his eyes off of the danger of a hostile takeover, and consequently we are not managing the way that we should manage.

I agree with the closing of the 13(d) window. I would also support and propose a broader opportunity for employee ownership, extending the time that the tender offer must stay open if an employee group is making a bid.

I would encourage long-term pension investment. Certainly, right now the pension managers are compelled to take the high dollar; in fact, I might say the high dime, without the right legally to exercise their judgment as to whether this is good for them or good for the corporation or good for society, which it seems to me are questions that need to be asked any time there is a corporate takeover.

I don't for one second adhere to the theory that this is simply a matter of what the stockholders want to do. That is a theory that is at least 100 years out of date, if it ever was up to date.

Certainly, what happened to Burlington Mills, what happened to R.J. Reynolds was of far more significance than just whether or not stockholders got the highest possible dollar. It took people out of jobs. It closed factories across several States. It shut down completely the research facilities of the major textile company in America. It put a burden of debt to such an extent that any fluctuation in the interest rates upward would cause serious internal financing problems for both Reynolds and Burlington and a number of other industries. We could, indeed, if as a result of our heavy national debt, or whatever other reason, have a substantial increase in interest rates, resulting in a series of bankruptcies across the country of these highly leveraged companies.

So there is a broader concern that must be expressed as we look at this unprecedented trend toward this kind of LBO and merger.

I agree with an anti-greenmail provision. I would approach it by prohibiting any 5 percent shareholder who commences a tender offer from making short swing stock profits treating them as any other insider. I would certainly prevent a corporation from being put into play unless the acquirer had adequate financing available.

I think that we ought to treat tender offers and leveraged buyouts the same way we treat the purchase of smaller amounts of stock, that anyone wanting to put up the security of a corporation; namely, the stock, can't borrow more than 50 percent. I think that ought to apply. If a purchaser is attempting to finance the entire company, no more than 50 percent of it should be financed by the pledging of the assets of the corporation.

To assure that the shareholder interests are fully and effectively protected in restructurings the bill requires that any such restructuring or going private the LBO must be approved by a majority of the committee of entirely independent directors who must first obtain and provide to the shareholders an independent appraisal of the corporation's value.

And then I would include provisions for civil liability for certain disclosure violations and would outlaw two-tiered tender offers.

That is a brief summary of the bill I am considering. My written statement contains more detail. Thank you very much.

[The complete prepared statement of Senator Sanford follows:]

Terry Sanford
United States Senator
for North Carolina

News Release

STATEMENT OF SENATOR TERRY SANFORD
THE NEED FOR A LONG-TERM INVESTMENT AND TAKEOVER REFORM BILL
HEARING BEFORE THE SECURITIES SUBCOMMITTEE
SENATE BANKING COMMITTEE
NOVEMBER 20, 1989

Thank you, Mr. Chairman. I appreciate your efforts in calling for this hearing to discuss various proposals to reform our takeover and leveraged buyout laws. As you well know, this is a subject that I have been very interested in and concerned about for some time. In part my concern stems from watching corporation after corporation in my home state, from RJReynolds to Burlington Industries to Cone Mills, J.P. Stevens, Holly Farms, now possibly Hardees Foods, Ivey's department store and Brown & Williamson Tobacco as part of the bid for BATUS and many others go through the trauma and destruction of highly-leveraged hostile takeovers and leveraged buyouts. But my concern also stems from having served on major corporate boards, as well as the board of the American Stock Exchange.

I am afraid that we have seen a fundamental shift from deals being done for sound financial and business reasons to the age of the eighties, when far too high a percentage of the deals are being done for financial manipulaton pure and simple. Their motivation lies most of all in the huge up-front fees for promoters, bankers, and lawyers who have no real stake in the long-run vitality of the firm.

But in reflecting on how we approach these issues and the experience we had last Congress in failing to pass S.1323, I have come to the conclusion that we need to shift the debate and the focus of our legislation away from the old "raiders" versus "entrenched management" fight to the more fundamental problems of encouraging corporate management to manage for the long-term and encouraging investors to take a longer-term view, at the same time that we curb the abuses that have led to excessive volatility in our markets.

As you know, last week we had two hearings in this Committee on America's competitive position. I was very struck by the testimony that was presented. Daniel Burstein, in reflecting on America's competitiveness challenges noted that that he is often asked "What is the number one thing we can do to reverse the current situation?" His response was that the number one priority is that as a nation, "we must bring an end to our malignant focus on short-term interests, short-term rewards and short term solutions." He went on to state that "When you think long-term, you begin to realize that however many instant

billionaires are created by speculative stock markets, managers focused on quarter-to-quarter profits, highly-leveraged corporate takeovers and rapid-fire Mergers & Acquisitions industry, we are witnessing not the competitive restructuring of American industry but a suicidal dismemberment of the very companies, sectors and industries in which America now has global competitive strengths." I agree.

I believe that much of the short-term orientation can be traced to changes that have occurred in the capital markets over the last twenty years, in particular, the growing institutionalization of the markets and the advent of highly leveraged acquisitions. As a result, I have tried to reshape the proposal I have been working on to focus on long-term investment and the integrity of the market.

As I result, I am considering legislation that is significantly pared down from the bill this Committee reported out last year, and the one that I promoted last year. The bill I am considering would do the following:

1. ENCOURAGE LONG-TERM PENSION INVESTMENT

In order to promote longer-term investment on the part of institutional investors, the bill would provide that fiduciaries of pension funds shall consider the benefits of long-term ownership of stock in deciding whether to tender their shares.

I think this is essential. Current case law virtually requires pension fund managers to tender their shares if the tender offer is even as much as a penny over the current market price, even if that manager fundamentally believes that the tender offer is not good for the long-term health of the corporation. This issue was touched on at the hearing that you conducted, Mr. Chairman, regarding the increasing role of institutional investors. I am afraid that portions of our ERISA laws, as well-intentioned and important as they are, have had the unfortunate side-effect of encouraging shorter-term investment and greater speculation in the market. I think the problem can be corrected without fundmentally changing our pension laws.

The bill would also prohibit the use of the surplus assets of a pension plan to finance a takeover or leveraged buyout. I think this will also help promote longer-term investment and sound pension plans, by taking the fear out of having excess investments that could become a magnet for corporate raiders.

2. EMPLOYEE OWNERSHIP

I also think encouraging greater employee ownership of

stock will help create more long-term owners, as well as giving employees the opportunity to become owners of capital. I would do so by giving employee groups greater time than the 20 days provided under current law to respond to a takeover. The provision I am considering would ensure that an employee group is given sufficient time to arrange financing if it wishes to participate in a transaction for the corporation and to promote long-term ownership by providing that the tender offer time period be extended to 90 days if a qualified employee group submits an offer that is substantially equivalent to other offers.

3. FIRM FINANCING FOR TAKEOVERS

The third area that I believe is crucial to promoting a longer-term look is to require those who want to buy corporations put some of their own funds at risk. As we learned from the S&L scandal, having your own capital at risk can be a great discipline. As it stands now, companies can be put in play with virtually no financial risk to the bidder. No money is put down; the deal is financed through "highly confident" letters or bridge loans to tide them over until enough assets are sold to pay back the purchase price, but little, if any, of the capital of the bidder is at risk. I think this contributes to the volatility in the market and the fear that anyone can be put in play at any time.

As a result, I am considering various approaches to place reasonable limits on the amount of real money that would have to be available before a tender offer can be mounted. The bill I am considering would prohibit a tender offer or leveraged buyout unless at least 50% of the financing is committed prior to the commencement of the offer. This financing could come from bank loan commitments or other sources, but would involve some financial investment on the part of the bidder, at least for bank commitment fees.

4. ANTI-GREENMAIL/SHORT-SWING PROFITS PROVISION

Another cause of the short-term focus and the volatility in the market stems from the huge short-swing profits that can be made simply by putting a company in play. My proposal to address this is very simple: treat 5% shareholders who file a tender offer exactly as we currently treat officers, directors and 10% shareholders of corporations. These individuals are deemed by the law to be insiders and as such, they cannot make profits on stock of their corporation that is bought and sold within a six month period. Certainly someone who is about to file a tender offer has the most essential type of "inside" information and should be restricted from making a profit simply by trading on that inside information.

When I suggested this approach last year, I thought it was a somewhat novel idea. I was intrigued, Mr. Chairman, at the hearing you conducted in October with institutional investors to hear Robert Kirby, the Chairman of the Capital Guardian Trust Company, suggest the same approach.

The provision would not affect those who are truly interested in buying a corporation, as such individuals would be unlikely to sell their shares back in less than 6 months after they bought them. The provision would thus only touch the true speculators, who are adding so much volatility and short-term trading to our markets.

As such, the provision also eliminates greenmail.

5. INDEPENDENT APPRAISALS AND INDEPENDENT REVIEW OF GOING PRIVATE TRANSACTIONS

The other area that we did not address in S.1323 that has clearly been shown in the RJR deal and others to be a problem is the conflict of interest of management participating in a leveraged buyout. Management has all the cards and can too easily manipulate the "fairness opinions" that are prepared regarding the offer. As such, to ensure that shareholder interests are fully and effectively protected in corporate restructurings, the bill I am considering would require that any such restructuring or going private plan must be approved by a majority of a committee of entirely independent, disinterested directors who must first obtain and provide to shareholders an independent appraisal of the corporation's value. This appraisal would have to be conducted by a firm that has no financial stake in the outcome of the deal.

In addition, the bill prohibits the consummation of any going private transaction until 60 days have elapsed since the public announcement of the transaction. I think it is important to give the markets some time to react to buyout offer, so that other bidders can enter the process and shareholders can be more fully informed about their options.

6. NON-CONTROVERSIAL TENDER OFFER REFORMS

Finally, the bill I am considering would pick up three smaller, but important items from S.1323 on which I think there is a great deal of consensus: 1. closing the 13(d) window, 2. giving the SEC broader authority to sue for violations of disclosure provisions, and 3. restricting creeping and two-tiered offers.

a. Close the 13(d) Window

I am considering simply reducing the 13(d) 10-day window to 5 days and prohibiting further stock purchases

until the 13(d) disclosure is filed with the SEC.

b. Civil Liability

Second, I would give the SEC the power to impose civil penalties for securities law violations and would recognize the courts' authority to impose equitable remedies such as divestiture or sterilization of voting rights as a necessary component of effective deterrence of tender offer disclosure violations.

c. Restrictions on Two-Tiered Offers

Finally, the bill would require that purchases in excess of 25% of the corporation's shares be made through a tender offer for all outstanding shares under the same terms and conditions, unless the acquisition is approved by the board of directors of the corporation.

Mr. Chairman, there are a few other ideas I have been considering as well, including the possibility of requiring a waiting period before shares can be voted and possible tax provisions, including those suggested by our colleague, Senator Kassebaum, that I believe would promote longer-term investment. In addition, I am looking at provisions to protect workers contracts and benefits that may be adversely affected by a takeover or leveraged buyout. Another area that the Committee may need to explore is the continuing role of the states in regulating corporate governance.

Obviously, I feel very strongly about this issue and about the need for reforms. I hope by cutting back on some of the Williams Act changes and focusing on provisions that will encourage a longer-term focus, we can move the debate along. We must enact legislation that will allow our corporate managers to get back to managing productive, competitive, job-creating companies that do the research and make the capital investment necessary for future growth and competitiveness in our global economy, instead of looking over their shoulders for the next raider and focusing only at quarterly results, while at the same time curbing some abuses in the market and ensuring the free flow of capital.

Mr. Chairman, I look forward to working with you and the members of this Committee to do just that. I appreciate your time and interest in this issue.

Senator HEINZ. Very well. Senator Sanford, thank you very much. We appreciate both your own verbal testimony and your full statement, and I am sure that we will have some questions for you.

Senator Specter, it is a great pleasure to welcome you to the Banking Committee.

STATEMENT OF SENATOR ARLEN SPECTER, MEMBER, U.S. SENATE, FROM THE STATE OF PENNSYLVANIA

Senator SPECTER. Thank you very much.

Senator HEINZ. We don't often get to see you here.

Senator SPECTER. Thank you, Mr. Chairman. It is a great pleasure to be here. I would perhaps have selected this committee were my distinguished colleague not already on the committee to have preempted the field under the rules of the Senate.

I am pleased to be here, and I commend the committee for taking up this important subject. I have introduced legislation, S. 1794, which follows, Mr. Chairman, from legislation which I had introduced in the 100th Congress, S. 634.

It follows a longstanding interest which I have had in the field. As a practicing lawyer, I defended against one of the early takeover efforts directed against a major Pennsylvania company, Leeds & Northrup, in the mid-1970's, was successful then as an attorney with Deckert, Price & Rhodes, and have seen the developments in the field which have caused so much problems nationally, and especially for our State of Pennsylvania, with the takeovers of Gulf and Koppers and Smith, Kline, then Pennwalt, and the current threat to Armstrong, and it is hard to know precisely what to do, but I believe that it is very important that the Congress, the Senate, focus on the issues.

There are certain things which I think can be done by way of more notice, which is a very healthy aspect, and the time schedules can be rearranged, I think, to provide for the public interest.

Mr. Chairman, I ask that the full text of my statement be included in the record.

Senator HEINZ. Without objection.

Senator SPECTER. And I will summarize very briefly as to some of the major points that I have suggested in the legislation.

The provisions with respect to 13(d) and the so-called creeping takeovers, I concur with both of my colleagues, Senator Metzenbaum and Senator Sanford, and I don't think it makes a whole lot of difference whether it is 24 hours, as Senator Metzenbaum says, or 48 hours, as in my bill, but the 10 day period allows a great deal of activity from the time of notice for the 10 days and there ought to be a shorter window, and I propose in my legislation to require that there be a standstill when the notice is given so that more shares cannot be acquire in the interim.

With respect to the leveraged buyouts, the management takeovers, my thought is that there ought to be a 90 day period, with the books of the company being available to others so that if anyone else wants to come in and buy the company that there be an opportunity to do so beyond the insiders.

The provisions of the junk bond-financed takeovers is a problem, and here again I believe that the situation would be substantially

improved if a 90 day period was available for others who might want to make a purchase to come in and take a look at the enterprise and make a competitive bid, and perhaps that acquisition wouldn't be made under such circumstances without the junk bond financing, which poses a real problem to the economy, as amplified by Senator Sanford, and I shall not repeat it at this time.

As to the margin requirements, putting companies into play, my thought is that if there were a private right of action that there would be a very substantial deterrent for violation of the margin requirements which are not adequately enforced at the present time.

Mr. Chairman, I think that uniform voting rights would be very helpful, although I do believe that there ought to be substantial deference to state law on the subject.

When the poison pill issue was raised in the U.S. Senate in June of last year, there was enormous concern in the corporate field. My telephone rang off the hook, as I think many Senators' phones rang off the hook, and a large delegation came from Pennsylvania and eventually that was the causative factor, as I understand it, for the bill to be taken down, so that that is a complex matter, and I frankly do not have an answer on that provision.

I discussed it at some length when it was on the floor with Senator Armstrong as to the issue of having shareholder approval for the poison pill, and that becomes complicated in terms of identifying who the shareholders are with so many shares held in trust and very complex arrangements.

But I do believe that there ought to be very substantial deference to what the States have done and not a preemption because they know their situations perhaps generally better than we do, although some of the matters have national application, such as the timing of 13(d) and other provisions, and as to some provisions some of the States have not acted at all.

Mr. Chairman, I also have provisions on greenmail and increased penalties, but they are spelled out at some length in my statement. So I shall not amplify upon them at this time.

And I see Senator Shelby has arrived, and I would ask to be excused, Mr. Chairman, for other commitments unless there is some pressing reason to the contrary.

[The complete prepared statement of Senator Specter follows:]

Statement of Senator Arlen Specter

Corporate Takeovers

Mr. Chairman, I am pleased to appear before the Subcommittee on Securities of the Banking, Housing and Urban Affairs Committee to discuss my bill, S. 1794. I appreciate the opportunity which you have provided for my colleagues and me to express our views on the very important issue of corporate takeovers. I am deeply interested in this area and plan to follow the process closely.

My bill is derived, in part, from legislation which I introduced in the 100th Congress as S. 634. It is based on my own experience as a lawyer in this field, and my own personal discussions with leading lawyers, economists, business analysts, and corporate executives.

The issue of corporate takeovers has been problemsome for the entire nation but particularly so for my state, Pennsylvania. It is obviously difficult to balance the interests of corporate democracy with the unproductive corporate takeovers where raiders manipulate the system for their own personal financial advantage. The legislative branch and regulatory agencies must exercise great care to avoid upsetting the free functioning of the marketplace.

In February 1984, the Senate considered legislation to provide for a six-month moratorium on acquisitions of oil companies. At that time, takeover efforts were being directed against Gulf Oil which had major Pennsylvania interests including its corporate headquarters in Pittsburgh and a refinery in Philadelphia. Notwithstanding parochial interests which might have been served by such a moratorium, I voted

against it because of the potential disadvantages to the free market. In June 1988 the Senate considered corporate takeover legislation, but the bill was taken off the Senate floor because of the uncertain consequences of federal legislation on the poison pill provision in state legislation.

It may be that modifications of the tax laws will provide some assistance on some of these issues. For example, on junk bonds, some current tax proposals would limit deductibility of interest and other proposals would seek to place equity investment on a par with debt for certain tax purposes. These issues are very complex and have to be thought through very carefully because they may have unexpected ramifications. Notwithstanding such considerations, in my judgment, the Congress must carefully consider these issues.

I have no expectation that this bill will be enacted in this precise form, and, frankly, that is not my intention. Rather, this proposal results from the evolving debate generated by corporate takeovers and it is my hope that this bill will help us to focus on the proper response Congress should adopt in this area. My views on certain of these issues may well change on the basis of upcoming debate and my ongoing discussions with business leaders, labor officials, workers and others affected by the takeover process.

While it is my sense that legislation is necessary at the federal level, I am also aware that the states have spent much time and many resources studying this problem. Thus, various approaches have been developed to govern the corporate structure. It is my intention to

closely monitor activity at the state level to determine the effect of their responses and the need for increased federal involvement.

I shall briefly summarize the bill's treatment of eight major issues of particular concern in the takeover field:

I. Creeping Takeovers

This bill would close the Williams Act's so-called 10-day window, which permits "creeping takeovers." The Williams Act requires any person who acquires five percent of a company's shares to make that fact public, and to disclose whether he or she has any plans to attempt a takeover. Under the Act, however, the individual need not make either disclosure for 10 days after having reached the five percent level. Because the individual can continue purchasing shares during the 10-day period, his or her ownership can greatly exceed five percent by the time the public actually is informed.

The 10-day Williams window thus permits a creeping takeover: the raider slowly and gradually purchases stock, careful to remain below the five percent level. Then, upon reaching five percent and triggering federal disclosure requirements, the raider rapidly purchases a powerful block of shares in the 10 days before disclosure must be made. What interests are served by depriving management and the market of this information for such a lengthy period? None, and having decided that accumulation of a five percent interest is so significant as to warrant disclosure, Congress should have required immediate disclosure. This bill does so by amending section 13(d)(1) of the Securities Exchange Act to require disclosure within 48 hours.

In addition, this section imposes a "standstill," prohibiting the acquisition of additional shares beyond the five percent threshold until disclosure.

II. Uniform Voting Rights

This bill would require that common stock traded on national exchanges have uniform voting rights. As a practical matter, publicly traded companies traditionally have adhered to the principle of one share-one vote. Recently, as part of the ongoing struggle by executives, raiders and their lawyers to carve out some tactical advantage, companies have sought to create common stock with nonuniform voting rights. These companies have issued shares with inferior voting rights--or no rights at all--as a way of raising necessary capital without the risk of undesirable votes by shareholders (for example, in a proxy fight to oust the incumbent management). In addition, there is concern that companies may issue shares with disproportionately high voting rights to friendly holders, who have indicated support for incumbent management.

To defenders of this new practice, the issue is one of private contract. So long as no purchaser is misled or deceived as to the voting rights associated with a particular share of stock, why should the company and the purchaser not be free to enter into this arrangement at a price reflecting its value? To critics, the context of the debate is as important as its contours: the new practice plainly is an effort to protect incumbent management from the threat of a takeover, and does so at the expense of shareholder democracy.

My sense is that the critics of nonuniform voting rights have the better argument, for the same reasons that we would not permit an ordinary citizen to sell or otherwise alienate his or her right to vote--even pursuant to contract, even with full knowledge as to the consequences, and notwithstanding that one might construct a perfectly tenable economic argument for permitting such a practice. I believe that the notion of shareholder participation in the governance of corporations should be preserved and encouraged. Indeed, there is strong evidence that the stock exchanges themselves prefer such an approach, although none of them acting individually can afford to impose such a requirement.

Accordingly, this bill would prohibit nonuniform voting rights within a class of common stock in any corporation traded on a national exchange. It would not affect the right of a company to differentiate among classes (for example, distinctions between common and preferred stock), and it would grandfather the shares of companies which already have issued nonuniform stock.

In recognition of the fact that the issuance of shares with disproportionate voting power may be done for legitimate economic reasons, my bill also would permit such action if approved by a majority of the votes of the aggregate outstanding voting securities of the issuer.

III. Two-Tiered Takeovers

The bill eliminates the coercive raider tactic known as the two-tiered tender offer. This tactic consists of an extremely attractive

first tier cash offer for only a limited number of shares--enough to give the offeror a controlling interest in the company's stock rather than for all the stock. If a controlling interest is obtained, the second tier of the takeover will occur: a much less attractive offer for the remaining shares, frequently not payable in cash. By making a two-tiered tender offer, a bidder may create a shareholder stampede in which shareholders tender their shares without awaiting a thorough analysis or management response. Shareholders may fear that if they do not subscribe to the high-valued first tier of the offer, they will be forced later to accept the lower-valued second tier.

I am not unaware, however, that many states have taken action in the area. In my own state of Pennsylvania, the legislature has enacted a statutory scheme which provides certain rights to shareholders in the event of a change of control of the issuer. In recognition that states have traditionally governed the corporate structure, my legislation would not be applicable in cases where the laws of the state of incorporation provide otherwise. While my sense is that uniform national standards in this area may be preferable, I believe that the wiser course is to study the effect of these laws before making a final judgment.

IV. Junk Bond Financed Takeovers

"Junk bond" leveraged tender offers occur in the context of a tender offer which is financed by non-investment grade securities. Because leveraged buyouts and junk bond financing have played such a key role in the takeover arena in recent years, debt has replaced

equity in the capital structure of many corporations. Indeed, it is estimated that more than $500 billion of equity capital has been replaced by debt during the past four years.

I am deeply concerned about the impact of increased debt on our economy. Some economists view leveraged transactions as potential time bombs that could explode in the event of an economic downturn. Businesses which are supported by junk bond financing may not be equipped to function in a less favorable economic climate and eventually could be forced into bankruptcy. The ripple effect, and the resulting impact on the American economy, could be severe.

While I generally support a "free market" approach to economic development, we must be careful to avoid creating transactions which result in an emphasis on short-term profits over long-term growth. Too often, this may lead to the unnecessary termination of jobs, closing of plants and the reduction of business commitment to communities and philanthropic causes.

Thus, the bill I introduce today would require a 90-day tender offer period for any tender offer financed by non-investment grade securities. A tender offer would be considered to be financed by non-investment grade securities if any part of the financing is provided from sources other than cash on hand, bank financing for which commitments have been received, or the sale of investment grade securities or common stock for which firm underwriting commitments have been received. In addition, the company would be required to

provide full access to its books and records to any other person who makes a bona fide proposal to acquire the company.

The 90-day tender offer period in the case of junk bond financed tender offers will ensure that the market and all other relevant parties have sufficient time to consider the attractiveness of the transaction. The requirement that other potential bidders have access to the company's books and records will aid in the development of potential alternatives and provide protection against the risk that shareholders will be deprived of the full value of their investment.

V. Management Leveraged Buyouts

Management leveraged buyouts, as the term indicates, occur when management employees propose to purchase the shares of the company for which they work. There has been considerable criticism of such transactions. In such situations, management is both attempting to buy a controlling interest in the company and advising shareholders whether to accept the purchase offer. In short, management is on both sides of the transaction, and obvious questions arise as to its ability to pursue personal self-interest while fulfilling fiduciary obligations to shareholders.

While I do not agree, as some have argued, that management should be banned altogether from attempting a leveraged buyout, I do believe that certain additional procedural safeguards are necessary.

Under my bill, a "management leveraged buyout" would be defined as an acquisition of a company in connection with which one or more members of the management of such company will own, directly or

indirectly, within five years of the consummation of such a transaction at least five percent of the equity capital of the surviving or continuing business.

My legislation would make two changes to the Securities Exchange Act in this context. In the event of a management leveraged buyout, whether by means of a shareholder approved business combination or a tender offer, my bill would require a 90-day period (either proxy solicitation period or tender offer period) before the leveraged buyout could be completed. In addition, the company would be required to provide full access to its books and records to any other person who makes a bona fide proposal to acquire the company.

When management is dealing with itself, it seems particularly appropriate to slow down the process and permit shareholders more time to analyze the situation, as well as provide a fair time period and information to encourage competing bidders to emerge.

VI. Enforcement of Margin Requirements

There are many industry practitioners who are deeply concerned that certain market participants exist solely to put companies "in play," with no serious interest in mounting a legitimate tender offer. It is believed that these persons often initiate the tender offer procedure without legitimate financing. One perceived abuse is the announced purchase of shares in violation of existing margin requirements. In order to ensure that the margin requirements are fully enforced, my bill creates a private right of action for the

issuer and any shareholder to enforce margin requirements and to recover any actual damages sustained as a result of their violation.

VII. Greenmail

As I stated above, I am deeply concerned about persons who initiate takeover activity without any real interest in completing a tender offer. In many situations, it would appear such activity is begun by raiders whose sole goal is to put a company "in play" in order to force a corporation into paying "greenmail," a premium over the market value of the shares. In other circumstances, the incumbent board of directors and/or management may pay such a premium in order to deter a legitimate takeover attempt or to buy back shares held in unfriendly hands.

Currently, the appropriateness of a corporation's payment of greenmail is judged under the state law "business judgment rule." Under this standard, the payment of greenmail is generally deemed to be within the discretion of the issuer's board of directors in the absence of proving bad faith or self-dealing. While I recognize there are certain circumstances which justify the payment of a premium to certain shareholders, I am deeply concerned that the current state schemes do not adequately protect the interests of small shareholders, who are often not in a position to litigate the "business judgment" of the company's directors.

In order to remedy real and potential abuses, my bill would permit a corporation to recover such greenmail payments, unless such payments were approved by a vote of the majority of the aggregate

outstanding voting securities of the issuer. In addition, it would permit a shareholder to bring an action on behalf of the corporation, if the corporation failed to do so after notice and an appropriate time to respond. My bill also permits the Securities and Exchange Commission to exempt certain transactions from this requirement, as it deems necessary.

VIII. Increased Penalties for Insider Trading and Other Prohibited Activity

Finally, my bill would increase the penalties for insider trading and perjury and obstruction of justice in that context to a fine of not more than $1,000,000 or imprisonment for up to 10 years or both. I believe that this increase takes into account the need for greater deterrence in view of the increased magnitude of financial deals during the past 10 years. In addition, in order to serve notice that our country takes these laws seriously, given the impact that these violations have had on the integrity and stability of our financial markets, my bill would also impose a minimum jail sentence of one year for such above violations.

Conclusion

Mr. Chairman, as I stated at the beginning of my remarks, I hope that this bill will serve to continue the in-depth debate and discussion which these issues merit. While I have spent considerable time studying these issues and formulating the major components of this bill, I know that there are many complexities in this area. While I am not unalterably committed to every particular provision of this bill--and, in fact, am continuing to seek input and advice from experts around the country--I am committed to moving the debate forward, and ensuring that the 101st Congress takes a serious look at these issues.

Senator HEINZ. Senator Specter, we thank you for your testimony. Of course, you are free to depart. We may have some questions which we will submit in writing to you. We thank you for being here.

Senator SPECTER. If you submit the questions in writing, I will answer them the next time I see you on the floor, Senator Heinz.

Senator HEINZ. Well, that is better than taking the Fifth. [Laughter.]

Senator Shelby, we are delighted to have you.

STATEMENT OF SENATOR RICHARD SHELBY, MEMBER, U.S. SENATE, FROM THE STATE OF ALABAMA

Senator SHELBY. Thank you. Thank you, Mr. Chairman.

Mr. Chairman, I was at another committee meeting trying to introduce someone over at the Armed Services Committee. I apologize for being late to all of you.

I will try to be brief. I have a written statement—it is very lengthy—that I have submitted for the record.

Senator HEINZ. Senator Shelby, without objection, your entire statement will appear in full.

Senator SHELBY. In the interest of time, I will make my opening comments as brief as I can.

I have introduced several bills this year that would modify securities law and, in my opinion, make a lot of the needed improvements.

In general, I believe that government should interfere as little as possible in the mechanics of the marketplace. Although I have at times personally questioned the merits of particular mergers and takeovers, I believe overall that economics will curb the excesses of the marketplace much more efficiently, Mr. Chairman, than would government intervention.

Recent tremors in the junk bond market and the subsequent effects on leveraged buyouts indicate this to be true in most cases.

This is not to say, however, that it is inappropriate for the government to protect against certain abuses. I believe that we have that responsibility. To accomplish this end, I have introduced what I have titled "The Investor Equality Act." Catchy title notwithstanding, this legislation is virtually identical to provisions in S. 1323, which was favorably reported by this committee in 1987, with the addition of certain very important shareholder rights provisions. These shareholder rights provisions are identical, Mr. Chairman, to the amendments which I and several of our colleagues successfully offered during the floor consideration of this measure.

Thus, the Investor Equality Act would close the 13(d) 10-day window, it would extend the minimum number of days provided to shareholders for review of tender offers, eliminate the creeping tender offer and "sweep the street" transactions.

It would also, Mr. Chairman, reform the proxy voting process—I think it is very important—by providing access to the proxy machinery for minority shareholders and by requiring the SEC to promulgate regulations requiring confidentiality in the granting and voting of proxies or a satisfactory alternative that assures the in-

tegrity of the proxy voting process and gives fairness to the shareholders.

This measure would restrict the payment of greenmail by allowing the company the right to recover any profit made by a person who sells the company its own stock, if that person, Mr. Chairman, holds more than 3 percent of the company's stock and has held it for less than a year.

This bill would also restrict golden parachutes, in my opinion one of the most flagrant abuses of corporate assets. This measure does not restrict how much a corporation pays its management, but merely seeks to ensure that corporate assets are not abused without shareholder knowledge. This measure provides that the payment of a golden parachute, as defined by the IRS at three times annual compensation, is prohibited unless affirmed by a majority of the shareholders.

This measure would prohibit poison pills unless approved by a majority of the shareholders. Poison pills, as you well know, Mr. Chairman, effectively give a company's board of directors, without shareholder consent, exclusive authority to decide if an acquisition can succeed or fail.

The Investor Equality Act would also increase the disclosure requirements applicable to purchasers of 5 percent of a company's stock and also increase the deterrents to violating disclosure requirements by authorizing the SEC to seek civil penalties for such violations.

Mr. Chairman, it is my firm belief that this legislation strikes a fair balance between competing interests in contests for corporate control.

I have also introduced legislation that would assist in preventing the excessive use of credit in the purchase or carrying of securities by providing a standing for a private right of action. Specifically, Mr. Chairman, this legislation would amend the Securities Exchange Act of 1934 by adding a provision which would permit an issuer of securities to bring a suit for damages against a purchaser of 5 percent or more of any class of such securities if the purchase of the securities violates the margin lending requirements.

I introduced this measure to ensure that margin violations do not go unpunished. The Securities Exchange Act authorizes the Board of Governors of the Federal Reserve to prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security. These regulations generally prohibit more than 50 percent of the cost of acquiring stock in a tender offer from being secured, directly or indirectly, by the stock of the acquired company.

While the Federal Reserve promulgates these regulations, it is the SEC that is charged with enforcement. However, I am concerned that the SEC—this is some of my past history with them—has shown little inclination to initiate an enforcement action against potential margin regulation violators, even in incidents where persuasive evidence exists.

In the absence of action by the SEC, the next logical place to turn for enforcement would be to the courts. Regrettably, while in the past there was a split of authority on the issue, the most recent

court pronouncements on the subject overwhelmingly conclude that no standing exists for a private cause of action in the courts.

Thus, even if the financing for a corporate acquisition is substantially suspect and potentially violates the margin requirements, the courts hold that no one can bring a private right of action to challenge the acquisition because there exists no standing to bring such an action. This legislation would rectify that and provide an opportunity for enforcement in the absence of SEC action.

I have also introduced legislation, Mr. Chairman, that seeks to put equity on equal footing with debt. This measure would amend the Internal Revenue Code to allow a dollar for dollar deduction of dividends paid by a corporation. Currently, the Tax Code bias toward debt promotes leveraged buyouts by encouraging the issuance of debt and discouraging the issuance of equity. Corporations may deduct from adjusted taxable income the amount of interest paid each year on debt, while dividends must be paid in after-tax dollars. This double taxation of corporate earnings effectively makes dividends, and thus equity, far more expensive than corporate debt.

Providing for the deductibility of dividends is not revenue neutral, as we all know. To the contrary, providing for the full deductibility of dividends would cost the Treasury an annual estimate of $20–$30 billion.

I recognize that passage of this measure is virtually impossible at this time of budget deficits. However, I believe that it is one of the first steps we should take after getting our fiscal policy in order.

Mr. Chairman, these basically are in a synopsis my proposal. I appreciate your holding this hearing.

[The complete prepared statement of Senator Shelby follows:]

Statement by Senator Richard Shelby
at Securities Subcommittee Hearing
November 16, 1989

Mr. Chairman, I appreciate the opportunity to testify at this afternoon's hearing to discuss with this Committee legislation that I and several of my colleagues have introduced, concerning tender offer reform and other corporate governance issues.

The tender offer reform legislation, known as S. 1323, which was favorably reported by the Senate Banking Committee in 1987 under the guidance of our former Chairman, Senator Proxmire, was considered briefly during the second session of the 100th Congress. S.1323 proposed several constructive and needed changes to our nation's securities laws: closure of the Section 13(d) 10-day window; extension of the minimum number of days provided to shareholders for review of tender offers; elimination of the "creeping" tender offer and "sweeping the street" transaction; access to the proxy machinery for minority shareholders; restriction on the payment of "greenmail"; and increased disclosure requirements applicable to purchasers of 5% of a company's stock. These specific reforms would further the original objective of the Williams Act by providing a fair

balance between the competing interests in contests for corporate control.

The dynamics which generated the Banking Committee's decision to favorably report S. 1323 during the 100th Congress have not changed considerably from those that exist today. Several changes should be made to our securities laws to ensure a fair balance between the competing interests for corporate control. I believe that Congress should act on this matter expeditiously.

Although I supported most of the provisions contained in S. 1323, I did not agree during the 100th Congress with the Committee's decisions regarding a fundamental issue of corporate governance: shareholders' rights. In my judgment, S. 1323 was lacking in provisions necessary to preserve the integrity of the shareholder franchise. The Committee should have considered and adopted measures designed to fill this void. I believe that specific provisions addressing "poison pills" and "golden parachutes" and requiring proxy voting reform, if incorporated in the legislation, would help provide the shareholder some of the safeguards that were lacking in S. 1323.

In the 100th Congress, I also believed that a provision ensuring equal voting rights for all shareholders was absent from S. 1323, and I had every intention of offering such an amendment for the Senate to consider during the course of its

deliberations with respect to S. 1323. Of course that opportunity never presented itself. The Senate did not complete consideration of S. 1323; and as a result of the SEC's promulgation of Rule 19c-4 last July which generally requires equal shareholder voting rights for prospective stock offerings, the issue of shareholder voting rights has, for now, been satisfactorily resolved.

During Senate floor consideration of S. 1323, the Senate did adopt amendments to S. 1323 addressing the "poison pill" and "golden parachute" problems. I have introduced a measure, S.1658, the Investor Equality Act of 1989, which is similar to the Banking Committee version of S. 1323 but also contains the substance of the Senate-approved amendments. To this bill, I have added a provision dealing with reform of the proxy voting process. In this manner, I hope to regenerate Senate debate on this subject, and possibly the 101st Congress will legislatively address the critical shortcomings currently existing in our securities laws in the corporate tender offer area.

I believe that the most serious problem that confronts our economy today is debt -- debt owed by our government, debt owed by our businesses, and debt owed by our citizens. The levels are staggering. The national debt will soon be over $3 trillion; the household debt is over $3 trillion; and the business debt is over $4 trillion. Soon interest on the federal debt will become the single largest component of the federal

budget, diverting money to pay for past expenditures and preventing the use of these resources on problems facing us today. Similarly, too much corporate debt means too much cash flow is diverted into debt service from research and development and from other new capital investment. Further, too much corporate debt is driving up the cost of capital thereby impeding sound long term corporate planning.

Unfortunately the key to a takeover is often debt. The bidder secures loans from a bank in order to purchase the shares of the target company. To repay these loans, the newly acquired company issues new debt and usually sells off assets to generate cash. Similarly, in defending against a bidder, a corporation may itself issue new debt in order to purchase its own stock so as to keep it from being acquired. While a takeover is often part of a legitimate business plan of a corporation to enter a new business or to acquire a going concern and thereby increase the corporation's ability to efficiently provide products and services, there is no doubt that there exist abuses associated with hostile takeovers. Certain corporate situations should be defined and addressed to insure that the vast amount of corporate debt our businesses are accumulating is being accumulated in an environment that minimizes the potential for takeover abuse.

In my opinion, the Investor Equality Act of 1989, attempts to deal fairly with the issues raised by recent hostile takeover

activity and tries to correct these abuses in an evenhanded manner. It does not protect current management at the expense of shareholders, and it does not unnecessarily interfere with legitimate business acquisitions. If enacted, the legislation should make the tender offer process more open and less prone to abuse. I believe the bill is comprehensive, responsible and balanced and that it is legislation that is badly needed.

Below, I have briefly outlined each of the provisions of the Investor Equality Act.

Summary of the Investor Equality Act

S. 1658

(1) Closing the 10-day window. -- Under current law, any person who acquires more than 5 percent of a company's stock need not file a disclosure statement until 10 days after the acquisition that exceeds the 5-percent threshold. This permits stock acquisitions much greater than 5 percent during the 10-day window period before any disclosure is required.

As a result, by the time the first disclosure is made, a person may have secretly accumulated a control interest in the company. The bill does not change the 5 percent threshold requirement. However, in order to alert shareholders of important purchases of the stock on a more timely basis, the bill requires buyers to disclose the acquisition of a greater

than 5 percent stake in the company within 5 days rather than the current 10 days of reaching this level of ownership. Further, until the disclosure is filed, additional purchases beyond 5 percent are prohibited. In this manner the average investor and the average shareholder will know more about what is going on.

(2) Disclosure of purchase intentions. -- As in situations where bidders accumulate substantial blocks of stock before reporting their purchases, shareholders selling target stocks are injured when a bidder continues buying stock after reporting but falsely states that he is merely purchasing for "investment." While such false statements are unlawful, they rarely result in significant penalties. The bill addresses this problem by requiring a more definite statement as to the intent of the bidder.

Under the bill, the bidder will be required to make a public announcement within 5 days of reaching more than a 5 percent stake in a company which public announcement will contain, among other information, a statement whether the bidder's purpose is to acquire or change control of the company or is solely for investment without any purpose or effect of changing or acquiring control of the company.

(3) Enforcement mechanisms to ensure accurate disclosure. -- The bill provides for an effective deterrent to violations of

its disclosure requirements. Although most courts allow shareholders and target companies to bring a civil action against persons who injure them by violating the Williams Act, some courts have denied them standing. Moreover, the courts typically limit the relief available in such suits to corrective disclosures by the violator, reducing the deterrent effect of such suits. Likewise, although shareholders have a right to obtain damages for injuries caused by false Williams Act filings, they must prove that they read and relied upon the filing -- rendering this right also an ineffective deterrent.

To increase the deterrents against violations of the disclosure requirements of the Williams Act, the bill authorizes the SEC to seek civil penalties for such violations. The penalties could not exceed 3 percent of the value of the securities involved per day so long as the violation continues, up to a maximum of 50 percent of their value. The bill also recognizes the courts' authority to impose, and specifically endorses the broader use of, equitable remedies such as divestiture, or sterilization of voting rights, as a necessary component of effective deterrence of tender offer disclosure violations.

(4) Tender offer reform. -- The 20 business day minimum offering period required by current SEC tender offer regulations often has proven inadequate to give most shareholders a full opportunity to receive, digest and act on tender offer

disclosures. The bill increases the minimum tender offer period to 35 business days. In addition, the bill provides that if a "qualified employee stock ownership plan" holds stock of a company that is subject to a tender offer and announces an intention to make a substantially equivalent competing bid, the minimum tender offer period is extended to 95 business days. For the longer minimum offering period to be applicable, the plan must have owned at least 10 percent of the voting securities of the company for at least 6 months when the competing tender offer commenced.

Under current law, the tender offer provisions of the Williams Act are not applicable to open market purchases of control -- "creeping" tender offers and "sweeping-the-street" transactions. In such transactions, target shareholders do not receive the disclosures or the procedural protections required in a tender offer. Although the courts have held that open market transactions are not subject to the tender offer rules, this view has been opposed by the SEC and many commentators who believe that such transactions permit evasion of the Williams Act. The bill extends the shareholder protections of the existing tender offer process to reduce the effectiveness of techniques used to acquire control of a company outside of the tender offer process. The bill requires, subject to certain exceptions, that any acquisition of a company's stock be made by means of a tender offer if the acquisition would result in the

purchaser having beneficial ownership of more than 25 percent of the target's outstanding shares.

(5) Reduction of greenmail. -- Certain actions taken by corporate raiders designed to force companies to repurchase a block of shares of stock at a premium, commonly characterized as "greenmail", represent some of the more outrageous forms of takeover abuses in existence. In order to limit the practice of "greenmail", the bill permits a company to bring a civil action for disgorgement of "greenmail" profits. The bill gives a company the right to recover any profit made by a person who sells the company its own stock if that person holds more than 3 percent of the company's stock and has held it for less than 1 year. The bill also permits shareholders to sue derivatively to recover "greenmail" profits on behalf of a company if the company either fails to bring such an action within 60 days after a shareholder request or fails diligently to prosecute any such action. This section does not apply if the stock purchase was approved by a majority of the company's shareholders or if the same purchase offer was made available to all shareholders. In addition, the SEC is given rulemaking authority to establish exemptions from this provision.

(6) Restrictions on golden parachutes. -- At the present time, there are no federal securities law restrictions applying to "golden parachutes". While federal tax law does subject certain of these payments to a 20% excise tax on the employee and makes

certain of these payments non-deductible for the employer, there currently exist no federal securities law restrictions on "golden parachutes". The only recourse now available to shareholders is to initiate a civil action alleging a violation of the amorphous business judgment rule.

A "golden parachute" can best be described as an exorbitant employment contract that guarantees a substantial severance pay to top management in the event that they lose their job as a result of a corporate takeover. It is not a regular type of severance contract, and it ordinarily becomes effective only in the event of a successful corporate takeover. This provision is not targeted towards the kind of contract that gives a valued employee a couple of months severance pay upon the loss of a job but rather is directed toward the type of contract that pays millions of dollars and that is intended to deter a hostile corporate takeover by threatening irreparable economic harm to the company, thereby denying its unknowing shareholders the company's value.

A "golden parachute" is one of the most flagrant abuses of corporate revenue and should be restricted in some manner. The bill does not seek to limit how much a corporation pays its management but merely seeks to ensure that corporate assets, belonging to shareholders, are not abused without shareholder knowledge. The IRS defines a "golden parachute" as a payment in excess of 3 times annual compensation, and I believe that

shareholders should be aware of payments of that size. The Investor Equality Act provides simply that payment of a "golden parachute" as defined by the IRS is prohibited unless such agreement has been approved by an affirmative vote of a majority of the aggregate outstanding voting securities of the company. Basically the bill just says that a company can pay a "golden parachute" but only if approved by the shareholders. If any such "golden parachute" was entered into prior to enactment of the bill, the bill provides that such agreement may not remain in effect for more than 2 years after enactment unless also approved by a vote of the shareholders.

(7) Reduction of poison pills. -- The bill substantively addresses the problem posed by "poison pills". "Poison pills" are usually an issue of securities, normally preferred stock, designed to discourage a hostile merger. Upon completion of a hostile takeover, the typical "poison pill" stock becomes convertible to cash or into common stock of the acquiring company. The effect is to raise the cost. Although such plans may be challenged in court as violative of the business judgment rule, there presently exist no federal securities law restrictions on "poison pills".

"Poison pills" represent one of the worst abuses of our federal securities laws in the corporate takeover area. They are bad medicine for companies and investors. They erect insurmountable barriers, without shareholder consent, to offers

from outside bidders for a company's shares except for those favored by management. They effectively give a company's board of directors, without shareholder consent, exclusive authority to decide if an acquisition can succeed.

"Poison pills" are undesirable because they deprive shareholders of the right to decide whether to sell their stock and, thus, to decide who controls the company, and because they deter offers that might benefit shareholders, thus reducing the value of the stock. The Investor Equality Act does not prohibit "poison pills" per se. It merely prohibits them unless they are approved by a majority of shareholders or unless they are authorized by an SEC exemption. It is not surprising, however, to discover that corporate management prefers not to seek shareholder consent for a "poison pill".

The bill also requires that "poison pills" adopted prior to the date of enactment of S. 1323 must be submitted to a vote of shareholders for approval within 4 years from the date of enactment.

(8) Reform of proxy voting process. -- Congress authorized federal regulations on the solicitation of proxies when it adopted the 1934 Securities Exchange Act and gave the SEC broad authority to develop rules that "are necessary and appropriate in the public interest or for the protection of investors." SEC proxy rules currently include disclosure requirements, timely

distribution of proxy materials, and prohibitions on false or misleading proxy statements. SEC rules do not presently require confidential proxy votes.

The failure to enact regulations to ensure the confidentiality of the proxy system for all shareholders results in protecting entrenched management. The current proxy voting system is dominated by corporate management, which has a strong vested interest in the outcome of controversial or contested items that are put to a shareholder vote. Therefore, shareholders are frozen out of the system by which corporate control is obtained and exercised.

The bill requires the SEC to promulgate regulations within 1 year after the date of enactment of the bill that require confidentiality in the granting and voting of proxies and that provide vote tabulation by an independent third party. However, the SEC is given the option to promulgate regulations within 11 months from the date of enactment of the bill that provide for an alternative to confidential proxy voting, if such alternative will assure -- (1) the integrity of the proxy voting process, (2) fairness to shareholders, (3) the unimpeded exercise of the shareholder voting franchise, (4) the insulation from improper influence to a degree that meets or exceeds the protection afforded by confidential proxy voting, and (5) the announcement of results of a vote following tabulation by an independent

third party certified in accordance with such rules and regulations.

The bill also requires the SEC, in prescribing its rules, to consult with the Secretary of the Department of Labor and hold public hearings, inviting the participation of all interested parties, including individual shareholders, securities issuers, institutional investors, and securities firms.

In order to improve shareholder access to the proxy process and as a part of the reform of the proxy voting process, the bill further provides that any 10 percent shareholder shall have the right to include a statement relating to any matter to be presented by the company for a shareholder vote, including candidates for election as directors, in the company's proxy statement. The shareholder statement must receive the same space, coverage and treatment as management's statements.

Prior to adoption of the Williams Act in 1968, federal securities laws did not regulate corporate tender offers. Since the Williams Act was enacted, vast changes have taken place in the way contests for corporate control are conducted. The Williams Act was originally intended to protect shareholders and investors by establishing disclosure and certain procedural requirements in connection with corporate tender offers. Today powerful new market forces and an array of newly developed

takeover techniques have undermined the effectiveness of the Williams Act. These developments have frustrated the principal purpose of the Williams Act -- the protection of investors and shareholders. Legislation is needed to close the gaps exposed in the Williams Act.

The fundamental goal of the Investor Equality Act is to reduce the opportunities for abuse under the federal securities laws as then in effect and to expand the protective mechanisms of such laws. This legislation effectively achieves these purposes chiefly through disclosures made to investors and shareholders when faced with competitors for a corporate enterprise.

With the inclusion into what is basically S. 1323 as reported by the Senate Banking Committee of specific provisions substantively addressing "poison pills" and "golden parachutes" and of a specific provision requiring rulemaking to reform the proxy voting process, the Investor Equality Act effectively closes the holes now existing in the Williams Act yet continues to preserve the balance between the competing interests for corporate control.

I have always subscribed to the philosophy that our capital markets should be allowed to react freely, generally unhindered. The capital markets will, given time, make the adjustments necessary to reflect changing economic circumstances and should

be permitted to do so without government interference save for the existence of a basic regulatory structure to ensure fundamental soundness and integrity. I have never perceived corporate acquisitions, hostile or otherwise, as evil per se. However, I have become increasingly concerned about our domestic corporate debt levels and the prevailing attitude that it is better to owe than to own.

Also, I have introduced separate legislation to clarify a confusing state of affairs which is presently occurring in the securities law area, particularly with respect to corporate takeovers. Section 7 of the Securities Exchange Act of 1934, among other things, authorizes the Board of Governors of the Federal Reserve System to prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security. Legislation for this authority was enacted for the purpose of preventing the excessive use of credit for the purchase or carrying of securities -- certainly a noble goal in today's present corporate debt ridden environment.

The Federal Reserve Board has promulgated a complex array of margin regulations pursuant to this grant of authority, many of which apply in the corporate tender offer area. The Federal Reserve Board's margin regulations generally prohibit more than 50% of the cost of acquiring stock in a tender offer from being secured, directly or indirectly, by the stock of the

acquired company. Many of the hostile corporate takeovers launched in the last few years have been so highly leveraged that the existence of margin regulation violations would appear likely.

With these myriad margin regulations in place, one would assume that while complex questions of interpretation will arise periodically, the regulations would be enforced. Incredibly enough, at least with respect to hostile corporate tender offers, that may not be the case. The Securities and Exchange Commission is the agency charged by statute with enforcing the Federal Reserve Board's margin requirements. However, the SEC has recently shown no inclination to initiate an enforcement action against potential margin regulation violators in the corporate tender offer area. Hopefully, under the new leadership of Richard Breeden, the SEC will become more assertive in investigating potential margin violators and in vigorously pursuing those individuals and entities responsible for the violations in the most appropriate legal manner.

In the absence of action by the SEC, the next logical place to turn for enforcement would be the courts. Unfortunately, while in the past there was a split of authority on the issue, the most recent court pronouncements on the subject overwhelmingly conclude that no standing exists for a private cause of action. Thus, without becoming mired in the legal jargon, even if the financing for a corporate acquisition is

substantially suspect and potentially violates the margin requirements, the courts hold that no one can bring a private right of action to challenge the acquisition because there exists no standing to bring such an action.

One does not have to be a Wall Street wizard to suspect that much of the takeover activity over the past few years has been transacted with margin lending violations. However, no one appears to be interested in policing the requirements. The Federal Reserve claims it is required by law to look to the SEC for enforcement; the SEC is apparently dropping the ball; and the courts state that no one else has the standing to become involved. The solution would be to pass legislation that provides for a private right of action for violations of the margin requirements. This is the simple purpose of the legislation that I have introduced.

My bill, S. 1849, would amend the Securities Exchange Act of 1934 by adding a provision which would permit an issuer of securities to bring a suit for damages against a purchaser of 5 percent or more of any class of such securities if the purchase of the securities violates the margin lending requirements. Further, the bill would be essentially retroactive for three years to allow the courts the opportunity to scrutinize many of the recent takeovers to ensure that margin lending violators do not remain unpunished.

Without legislative action, margin violators will continue to roam across our capital markets with total disregard for the financial safeguards designed for, among other purposes, the protection of the small equity investor and small bondholder. I urge my colleagues to support this measure.

The final bill that I would like to discuss is a measure that I introduced during June of this year. This legislation, S. 1161, would provide a deduction to companies for dividends paid to its shareholders to correspond with the deduction already permitted to companies for the interest it paid on corporate debt.

This bill would amend the Internal Revenue Code of 1986 to provide for a deduction for corporations for dividends paid during the taxable year. This deduction would be to corporate adjusted taxable income and would be for the entire amount of dividends paid.

This legislation is intended to help balance the scales in the realm of corporate finance. Currently, the tax code bias toward debt promotes leveraged buyouts by encouraging the issuance or assumption of debt and discouraging the issuance of equity. Corporations may deduct from adjusted taxable income the amount of interest paid each year on debt, while dividends must be paid in after-tax dollars. This double taxation of

corporate earnings effectively makes dividends, and thus equity, far more expensive than corporate debt.

For this reason, the rash of corporate restructurings that has occured over the past several years has resulted in a steady decrease in the issuance of equity and a dramatic increase in the issuance of debt. Alan Greenspan, Chairman of the Federal Reserve, testified before the House Ways and Means Committee that the 1980's has been characterized by the retirement of substantial amounts of equity, more than $500 billion since 1983, most of which was financed by borrowing.

Chairman Greenspan continues by noting that the "accompanying increase in debt has resulted in an appreciable rise in leverage ratios for many of our large corporations." Business Week estimates that the debt of nonfinancial companies has nearly doubled in the last six years, to $1.8 trillion.

I am not a foe of corporate restructuring. I believe that in many cases, takeovers, hostile or friendly, result in beneficial streamlining and increased efficiencies that make U.S. products and services more competitive in the global marketplace. Takeovers prune businesses of complacent management and unwieldy bureaucracies and put pressure on management to adopt cost-efficient, competitive labor and production strategies.

However, I am concerned over the mounting debt burden on the shoulders of corporate America. While the aggregate debt-equity ratios of corporations have increased sharply, the ability of corporate America to service this debt is decreasing. The current ratio of gross interest payments to corporate cash flow is approximately 35%. This is similar to the peak level in 1982, when interest rates were much higher and profits much slimmer. This current high, however, comes at a time when profits have been handsome and interest rates reasonable. What does this augur for the next cyclical recession?

The recent surge in debt is concentrated; a Morgan Stanley report states that 95% of the increase in net interest outlays is concentrated in industry sectors that account for only 30% of GNP. Interest outlays for the three industries - nondurables, manufacturing, public utilities, and services - have risen at a rate of 10% per year, while net interest for the remainder of the economy has risen at the modest rate of 1.4% per year.

Morgan Stanley notes that two of these three sectors are less sensitive to recessionary pressures. Demand for utilities and services remains fairly constant during economic downturns but the same is not true for the manufacturing sector. Federal Reserve Chairman Alan Greenspan estimates that roughly two fifths of recent mergers and acquisitions have taken place in "cyclically sensitive industries" which are more apt to experience problems during a recession.

We cannot know until such cyclical downturn arrives what consequences will befall our economy. The rising interest rates and narrower profit margins that characterize a recession, associated with the inordinately high debt-equity ratios of sectors of corporate America, could result in record defaults and a severely sharpened recession.

The impact of widespread default on the holders of corporate debt could be catastrophic. Chairman Greenspan, characteristically succinct, indicates that the Federal Reserve is concerned over the increasing share of the restructuting loans made by commercial banks and admits that "massive failures of these loans could have broad ramifications."

I offered S.1161 with the intention that it might serve as a catalyst for debate. Providing for the deductability of dividends is not revenue neutral; to the contrary, providing for the full deductability of dividends would cost the federal government an annual estimated $20-25 billion in lost tax revenue. I do not offer an alternative source of revenue; and in this era of big budget deficits, I do not foresee passage of legislation that results in such tremendous cost to the government.

However, it is time to begin the effort to remove the bias toward debt that the Internal Revenue Code currently holds. While I do not want to manipulate or restrict the dynamics of

the marketplace, I firmly believe that we should not encourage through the Internal Revenue Code the assumption of debt over the issuance of equity. Corporate restructuring for the sake of efficiencies and increased productivity is right; corporate restructuring for the sake of transactional and legal fees is wrong.

Corporate governance issues were debated at length during the 100th Congress and most of the members of this Committee have a very good working knowledge of the issues at stake. It is my hope that the Committee would be able to move on these issues next spring, perhaps by developing a Committee consensus package. I commend the Chairman for holding this hearing and demonstrating his willingness to tackle these issues and I look forward to working more closely with him and my colleagues on these issues.

Senator HEINZ. Senator Shelby, thank you very much.

I just want to note that Senator Kassebaum is here, and, Senator Kassebaum, do you have any opening statement you would care to make at this point.

Senator KASSEBAUM. Just briefly, Mr. Chairman, because Senator Mikulski and myself introduced legislation last week. I think, obviously, all of us have some similar provisions in all of our legislation, and I think it indicates a widespread interest in trying to address balanced legislation that can begin to remedy some of our concerns regarding the whole takeover activity.

And so, Mr. Chairman, in hearing some of the testimony—and I didn't hear Senator Metzenbaum—and I know I missed something—and all of Senator Sanford's, and I know Senator Sanford and I have worked together through many similar things that we have all touched on—closing the 13(d) window, and we have all talked about, I believe, the independent appraisals—I didn't hear all, Senator Shelby, of your comments—and the financing requirements in one way or another.

So I would just say, Mr. Chairman, that I think the fact that we have all recognized some real problems here, all trying in various ways to address them, indicate that, I am sure, we can come up with a bill that incorporates various facets of all of these topics.

And I will just make my full statement a part of the record.

Thank you.

Senator HEINZ. To share this microphone with you is a pleasure, however, I feel a little impolite dragging it away.

But without objection, it is ordered.

Senator KASSEBAUM. Thank you.

[The complete prepared statement of Senator Kassebaum follows:]

PREPARED STATEMENT OF SENATOR KASSEBAUM

Senator KASSEBAUM. Mr. Chairman, in the last decade, we have witnessed a dramatic increase in corporate restructuring and takeovers. These restructurings have included mergers, tender offers, and leveraged buyouts. The volume of these transactions has increased from $67 billion in 1981 to $226 billion in 1988. Leveraged buyouts alone have increased from $3 billion in 1981 to $67 billion in 1988.

The pace, scope and impact of the corporate restructuring phenomenon has, and should, cause concern among the members of this body. The takeover process raises fundamental policy questions regarding the efficiency of our capital formation, the integrity of our capital markets, and the interrelationship between shareholders, management, directors, and other corporate constituencies such as employees and communities.

Perhaps the most significant question is whether the takeover process is fundamentally flawed. Too often we hear of situations in which the rules and regulations governing takeovers, which were intended to protect investors, are abused or manipulated for self-serving purposes. It is also clear that the markets themselves have changed so dramatically in recent years with respect to developments in technology, financing techniques, and products that many of our securities laws are obsolete or ineffective in accomplishing their intended purposes. The time has long passed to implement necessary reforms. All too often, however, the reaction of members has been to paint with too broad a brush by condemning all takeover activity or all defensive tactics that may be utilized by management.

This kind of approach has been counterproductive and unsuccessful. Just last year, this body failed to reach an agreement on some long-overdue changes to modernize our securities laws. Unless we are prepared to address these issues responsibly and with a balanced approach, the legislative stalemate will continue. In the interim, we will continue to see abuses of the takeover process which will under-

mine the integrity of our markets, and which ultimately reduces the competitiveness of United States markets in the global arena.

Our goal should be to identify those flaws in the takeover process or manipulative practices and deal with them in a surgical fashion. Some corporate restructuring transactions are clearly based on sound economic considerations and result in desirable efficiency gains, while others are ill-conceived and only benefit a cadre of insiders, lawyers, and investment bankers who reap enormous fees.

Accordingly, I am quite pleased to have introduced with Senator Murkowski the "Corporate Integrity and Full Disclosure Act." This legislation takes a balanced view of the takeover process and is intended to remedy specifically some of the most glaring weaknesses of our securities statutes. Its goal is to restore a measure of faith in the fairness of our securities markets.

To ensure full and timely disclosure of significant ownership of corporate stock, the legislation reduces the Section 13(d) ten-day window to five days and prohibits further stock purchases until the disclosure required by the statute is filed with the Securities Exchange Commission. This change in current law was first suggested nearly a decade ago. It will close what is unanimously acknowledged as a loophole in the current reporting scheme. Unfortunately, however, we have previously allowed this small, but vitally important, reform to be subsumed in the broader debate on corporate governance issues. As a consequence, hostile acquirers and arbitrageurs have been able to obtain significant positions in companies without providing adequate disclosure either to the market or to the other shareholders.

To ensure that shareholder interests are fully and effectively protected in corporate restructurings, the bill requires that any corporate restructuring plan subject to Section 13(e) or 14(d) of the Securities Exchange Act of 1934 (Exchange Act) must be approved by a majority of independent directors who must first obtain and provide to shareholders an independent appraisal of the corporation's value.

This provision addresses a potential conflict of interest in leveraged buyouts, particularly by management, that calls into question the ability of shareholders to have their interests protected. On the one hand, management owes a fiduciary obligation to the shareholders as the owners of the company. On the other hand, if management participates in the buyout, it is certainly in their interests to secure the best possible deal for themselves, even at the expense of the public shareholders. The current practice of addressing this interest conflict has been a "fairness" opinion from an investment banker who may have a financial interest in the outcome of the transaction. Unfortunately, these fairness opinions are often meaningless, if not fraudulent. In many cases, a fairness opinion means only that the offer price is above the pre-offer market price.

To protect the capital markets and shareholders from abuses associated with the use of credit in stock acquisitions, the bill creates a private right of action for violations of Section 7 of the Exchange Act and the rules and regulations thereunder, pertaining to margin requirements. This provision is intended to augment the authority of the Commission to bring actions for the margin violations by enabling aggrieved parties also to bring such actions.

To ensure the integrity and effectiveness of Section 13(e)(1) (regarding disclosure requirements for issuer stock repurchases) the bill broadens the reach of Section 13(e) to include affiliates of the issuer and includes within the definition of "affiliate" those corporate managers who acquire, directly or indirectly, 5 percent or more of the surviving corporation within three years of the stock repurchase. The provision is intended to address attempts to avoid disclosure requirements when management participates in a buyout transaction after it has been consummated.

To ensure the integrity of our capital markets and the effectiveness of securities statutes, the bill empowers the SEC to impose civil penalties for certain securities laws violations. Under current law, the only remedy generally available when a person violates the disclosure requirements of the Williams Act is to obtain corrective disclosure usually after it does any good. A violator knows in advance that he can obtain the benefit of his misdeeds. This legislation will give the Commission the authority to impose civil money penalties for disclosure violations and thus can provide an immediate deterrent to disclosure violations.

To ensure the full and effective disclosure intended by Congress, the bill clarifies that Congress intends that "source of financing disclosures" require the actual sources and amounts of financing be specifically identified and committed at the time of the disclosure. Section 13(d) of the Exchange Act requires disclosure of financing arrangements for stock purchases. This disclosure requirement has been incorporated into Section 14(d) as well. The Commission has taken the view that Congress did not intend to require that such disclosure necessarily be made at outset of the offer. This is simply an incorrect reading of the express language of the statute.

Just as disclosure of the number of shares being sought and consideration to be paid is to be made at the outset of the offer, there must also be meaningful disclosure of specific financing commitments. Vague statements of confidence that financing will be or may be provided at a later date clearly undercut the Congressional intent to have all meaningful information available to shareholders to enable them to make an informed investment decision.

Mr. Chairman, our securities laws assume full, accurate, and meaningful disclosure and stringent enforcement of these law if violations occur. Our current laws have become antiquated in both regards. To restore confidence in the integrity of our markets against potentially manipulative activities of cabals of managers, raiders, lawyers, and investment bankers, our securities laws must be effective. I look forward to working with my fellow senators in what must be a collective and balanced approach toward achieving this goal.

Senator HEINZ. I want to thank all three of you for a very good series of presentations.

I have been on this committee along with Senators Shelby and Sanford long enough to know that when you talk about anti-takeover legislation that what we are talking about is trying to cure a variety of different kinds of ills.

One is to presumably prevent takeovers of well-managed companies. It seems illogical to us that they should be taken over and subject their employees, the communities in which they have served to the kinds of stress that high debt loads and subsequent spinoffs inevitably create. Certainly there is a goal here of preventing that.

Second, where things like greenmail and golden parachutes are concerned, what we are trying to do is prevent what you might call insider abuses, taking advantage of a position of trust to line somebody's pocket, usually the insider's pocket.

A third goal, I suppose, is to prevent the entrenchment of incompetent management, again preventing them from being subject to takeovers by putting in, what some view, as unjustified poison pill defenses. That is what the proposals, which are loosely described as corporate democracy—one man/one vote requirements and, subjecting all poison pills to a vote of a majority of shareholders—are all about.

A fourth objective is—and I think this is what some of the Williams Act amendments are aimed at—is just making it more difficult to put a company into play in the first place.

And finally, there is an effort to ensure that shareholders don't sell too early. If they sell too early, they may not get all the so-called control premium that economists refer to or to be protected against selling too late. Maybe they will get squeezed out if they don't tender in time.

So we have all these and probably some other perfectly legitimate public policy concerns, but it is clear that some of them conflict. To the extent you want to prevent takeovers, you may be entrenching incompetent management.

Given a choice—and this is not the choice in the bills before us—but given a choice between making it more difficult for companies to be taken over or entrenching not very competent management, which should we do?

Senator Metzenbaum, you were here first. So we are going to give you the chance to hit that softball out of the park.

Senator METZENBAUM. As a matter of fact, I think it is a good question, and I don't know if I can give you a good answer, but I don't think it is too difficult.

I think that this committee is capable of fashioning an answer to that question that doesn't make it so protective of the entrenched management and yet also concerns itself about the shareholders, and I don't mean to be glib or cute in saying that. I do believe that in some instances entrenched management has been totally unconcerned about the shareholders. I do believe in some instances good management has not been adequately protected by raiders. But I think that it is possible to find a reasonable middle ground that is fair on all sides, and I would be very happy to work with this committee in trying to fashion such a proposal regardless of whose name is on the bill.

Senator HEINZ. Senator Metzenbaum, you may very well be right, and whatever the case may be we will ensure that the record accurately reflects the fact that you are not cute, except to Shirley Metzenbaum.

Senator METZENBAUM. I am very hurt by your saying that, and I resent it. [Laughter.]

Senator HEINZ. Senator Sanford, I kind of offered Senator Metzenbaum a Hobson's choice. He in one sense quite properly said that there are people on the Banking Committee who can solve that.

You are a member of the Banking Committee.

Senator SANFORD. Well, I am reinforced, though, by the Ranking Member.

The term "entrenched management" strikes me as being somewhat overused. In my observation of the various takeovers that we have followed very carefully over the last six or eight years since the junk bond fad came into being, it is really very difficult for a management to resist a tender offer regardless of whether they are entrenched or not. There are very few examples of management that didn't have to succumb to the acceptance of offers of increased stock value. Part of the problem is that the stockholder is no longer the old stockholder that has a few shares and makes an individual decision, but most likely to be a number of large stockholders, pension funds and mutual funds, that pretty well make their decisions not on whether management is entrenched or whether they want better management. In fact, they are saying they don't care about the management, let her go and give us the high dollar.

So I think the evidence is overwhelming that the stability of the company needs more protection than the person who would attempt to take it over for the various kinds of profits and fees that are involved in these kinds of transactions.

I don't think that we see many cases of shareholders being abused. Most shareholders, thinking that a company is not well-managed, will find a way, in short order usually, to get out of it; simply to sell their stock and move on. I don't really think entrenched management has been the real problem.

Senator HEINZ. Senator Shelby, do you have a comment on that?

Senator SHELBY. I want to try to answer that.

I believe that, obviously, that we ought to have confidentiality in our voting process. That is one. I just thought I would touch on that.

You know, we have that at the ballot box the way you are elected in Pennsylvania and everybody is elected that I know of in this country nowadays. You have that protection. But we certainly don't have that protection in corporate America, and a lot of people—some people on the street that own very few shares, they don't realize that. They haven't realized that.

But to try to get a corporate takeover, would we like so-so management, so to speak, in there? How do we balance that?

I don't know. Some of that jurisdiction lies within our committee here as to how to legislate. Some, as you well know because you serve on the committee, will lie in the Finance Committee because a lot of it, as long as we have the tax policy on the deductibility of interest on the debt wide open, I believe that if the junk bonds can make some kind of comeback, you know, the market will be out there for it. But as I said earlier, basically the market will determine a lot of stuff, you know, whether or not this is a viable situation.

But I believe in the committee that we can form something. We can work with all of us' bills and come out with a committee print. We don't care whose bill it is as long as it has substance in it.

Senator HEINZ. I want to agree with one thing in particular that you said, Senator Shelby, and that is that the tax laws have a tremendous impact on what is happening out there in the marketplace.

Senator SHELBY. We make the social and economic policy through a lot of the tax laws. Would you agreement, Mr. Chairman?

Senator HEINZ. As a witness before this panel, I would say yes, Senator Shelby.

Senator SHELBY. And as a member of the Finance Committee, you would have to say that because it is true, isn't it?

Senator HEINZ. And the founders probably intended it that way.

It doesn't offend me to make policy through the Tax Code. In fact, it is probably on balance a better way than most of the ways we do it around here.

Senator SHELBY. A lot of good things come out of it.

Senator HEINZ. In Europe, policies are made by an unelected bureaucrat in charge of making those decisions as opposed to the people who are affected by the decisions.

Senator SHELBY. I totally agree.

Senator HEINZ. I want to ask you, Senator Shelby, about the issue of confidentiality, but I want to kind of come back to the big picture for a moment.

Senator SHELBY. OK.

Senator HEINZ. Would you both agree that part of what we are trying to do with any and all these bills is to prevent the takeovers of well-managed companies? Do both of you agree in that regard?

Senator SHELBY. That would be part of my idea.

Senator SANFORD. It would certainly be my main objective.

Senator HEINZ. Well, I have got a list here of some of the most famous takeovers of the last couple of years. Certainly, some of the

biggest—KKR's takeover of RJR/Nabisco, Phillip Morris' takeover of Kraft, and the Goldsmith takeover of BAT, Grand——

Senator SHELBY. That has not happened, though, has it?

Senator HEINZ. Not yet.

Senator SHELBY. The BAT thing is——

Senator HEINZ. That is right, it is still going on.

Senator SHELBY [continuing]. Still playing.

Senator HEINZ [continuing]. Grand Metropolitan's run at Pillsbury, Campeaux/Allied Federated, Bezer/Koppers in my hometown of Pittsburgh.

Senator SHELBY. That you well know and we know from your initiation of the committee what happened with that.

Senator HEINZ. Georgia Pacific taking over Nekoosa and West Point Pepperell, as Senator Sanford may recollect, J. P. Stevens.

In any of these bills, yours or anybody else's, do we think that any of these takeovers would have been stopped by any of the bills before this committee?

Senator SHELBY. Can I?

I believe that the takeover—not that one. I was going to do an addendum—the takeover of West Point-Pepperell by Farley Industries I believe, if the margin requirements had been enforced by the Federal Reserve, would not have happened. That is my opinion and the opinion of a lot of other people. That is one of the things it touches on in my bill.

Senator HEINZ. I would agree that the margin requirement issue, which was very much a question in the Bezer/Koppers takeover——

Senator SHELBY. That is exactly right.

Senator HEINZ [continuing]. Because of the way the financing was structured.

Senator SHELBY. But if the Chairman will recall, if I can just enter in a colloquy with him now——

Senator HEINZ. By all means.

Senator SHELBY [continuing]. You initiated hearings here in this committee on that, and you were very concerned with the margin requirement, as I was on the West Point-Pepperell/Farley deal. But there had been a precedent set. I don't know if it was before the situation in Pennsylvania or later in Georgia-Alabama with West Point-Pepperell deals. But nevertheless, there had been a precedent by the Federal Reserve Board. I don't know whether it was under Dr. Volcker's tenure or later under Dr. Greenspan's, but it had happened there, and without the Federal Reserve Board enforcing the margin requirements—and there is no private action—we were left, as you well know, with nothing we could do about it.

Senator HEINZ. Senator Sanford, please.

Senator SANFORD. I simply would say that legislation that I put in last time and would propose now would be designed to prohibit the fully leveraged takeover either as a hostile takeover or an insider, and clearly every one you mentioned I think might have taken place, but it would have taken place under much sounder financing circumstances. Certainly these deals could not have taken place as they were carried out.

Senator HEINZ. Senator Sanford, as I understand your bill, the principal barrier to a takeover would be the part of your bill that

says a tender offer would be prohibited or a leveraged buyout would be prohibited unless at least 50 percent of the financing is committed at the outset of the offer.

Is that what you are referring to?

Senator SANFORD. Yes. That of course is the fundamental guard against the full use of junk bonds.

Senator HEINZ. I am guilty of not having read the fine print and definitions of your legislation, but as you know, some investment banking firms have done a terrific business in "committing money" to deals with their highly confident letters.

Under your legislation would a highly confident letter be considered a commitment?

Senator SANFORD. No.

Senator HEINZ. Would a bank——

Senator SANFORD. They would have to have a firm commitment.

Senator HEINZ. Would a bank's swing financing be considered a commitment?

Senator SANFORD. No.

Senator HEINZ. Cash on the barrel head would be considered a commitment?

Senator SANFORD. Real money or firmly committed financing.

Senator SHELBY. The strongest.

Senator HEINZ. Anything short of cash?

Senator SANFORD. Well, I think that the binding commitment of a financial house would be a different kind of an instrument than we are now seeing, and would be the equivalent of cash.

Senator HEINZ. One of the issues that we get into and have gotten into in this committee is at what point we want to preempt States rights.

Senator Shelby and Senator Sanford, you are both strong States right advocates. I have heard you both, and I commend you for it. Some of the elements of the legislation before us insert Congress for the first time into relationships between shareholders and directors and corporate management. That traditionally is not an area the Williams Act has involved. The Williams Act is involved with protecting shareholders and not interfering in those relationships.

How should we approach this question of philosophy?

Senator Shelby.

Senator SHELBY. First of all, coming from the deep South and always——

Senator HEINZ. As opposed to?

Senator SHELBY. The upper eastern part of the Southeast, I guess. [Laughter.] And being associated for many years with States rights, the concept, I don't believe we should Balkanize our securities laws in any way, and sometimes for the betterment of the country I think we should preempt the area. Now, we would have to get into the exact, you know, nitty-gritty details of what we are doing there because I think it is a tough call sometime.

But just to say that or use the argument of States rights, this and that, to keep us out of an area, even as a Southerner I wouldn't advocate that.

Go ahead, Terry.

Senator SANFORD. I have never been a States righter. I have——

Senator HEINZ. I don't need to ask you the question, then.

Senator SANFORD. I have taken the view of States' responsibilities seriously, but I consider myself more a strong advocate of federalism, which is a unique contribution of American government.

I find it very easy to rationalize this particular difference because I think, with great success and certainly historically, the States have decided the basic issues of corporate governance. It is a well-established body of law, and we have long ago, certainly after the troubles of Wall Street in 1929, established that the regulation of securities is primarily a national function simply because of the nature of those transactions. We have drawn the line in an understandable way between corporate governance and the regulation of securities. I would like to keep it that way, and I think that is a fair division and a workable division and one that has been successful.

Senator SHELBY. Mr. Chairman, I would also add not only—I didn't say I was a States' righter. I said I had been associated with States' rights because of coming out of the South, for better or for worse sometime, but when we deal with securities, not only are they national in scope but nowadays more international in scope, and I don't know how the States can really play a role that some people envision in such a global market that we are running into, that we know about, and is not just going to go away.

Senator HEINZ. Senator Shelby, I don't think anybody I know of is arguing that there shouldn't be a national interest in securities transactions. In fact there already is a clear national interest in the regulation of securities. But the question I asked actually is a little different than that. It had to do with corporate governance and the relationships between shareholders, directors, not in the markets per se——

Senator SHELBY. Like the Delaware syndrome?

Senator HEINZ [contining]. But between shareholders and the directors and the management and, as you know, that has been a province of the States. I know none of you are suggesting national chartering of corporations.

Senator SHELBY. No, no.

Senator HEINZ. But let me ask you a question a little differently. In a sense, it is the same question, but it is a different question.

Let's grant that we can make some improvements on the margins here. The Williams Act, which is our act to protect shareholders against manipulation and abuse, was when it was written quite clear in its intent to remain neutral in battles between bidders and targets. That was its objective. We can argue whether or not it was well-written, but I have two questions.

Do you think that on balance the Williams Act is still neutral and, if not, why not, and in any event, is neutrality the objective we ought to seek?

Senator SHELBY. Well.

Senator HEINZ. Let's start with the last question first.

Is neutrality the objective we should seek?

Senator SHELBY. If you can say neutrality is fairness there, you know, maybe you could argue that. I don't really know.

See, I have an advocate's point of view at times.

Senator HEINZ. Yes.

Senator SHELBY. And I am sure management does, shareholders' groups do.

Senator HEINZ. It is possible that neutrality is just as subjective a word as fairness.

Senator SHELBY. It is. It might be an objective, but in the real world maybe we can't get there to the point of neutrality.

Senator SANFORD. I think that we ought to aim toward neutrality. I think that what has happened since the Williams Act was written was that the clever people who get paid big fees for doing it have found various ways to make it not neutral. I wouldn't attempt to analyze it right at this hearing, but I think we need to look very carefully to make certain that it indeed is neutral and can't be bypassed or that we haven't developed loopholes that ended the neutrality to the extent we ever had it.

Senator HEINZ. Of all the elements of the Williams Act and with all the creativity of all the smart and, I guess, pretty well-remunerated corporate lawyers who figure out a way to get advantage for their clients notwithstanding the intent of the law and the Williams Act specifically, where do either of you think the single worst Williams Act problem is?

No comment at this point.

All right. Senator Shelby, I want to ask you a question about the issue of confidentiality because there are numerous proposals that have been made to require the kind of same secret ballot that you and I think we have a right to when we stand for election or reelection.

The argument for it is pretty obvious. The argument against it is that the SEC has expressed the view that confidentiality is inconsistent with fund managers' fiduciary duties in the following sense, that beneficiaries under managed accounts such as pension funds have a right to know how their fiduciaries, the fund managers, voted. So you are correct as well.

There is a conflict between the knowledge of the beneficiaries and how all these institutional investors vote and our desire to prevent the institutional investors from being discriminated against if they vote against management.

Senator SHELBY. Is it? Is it really, though?

Senator HEINZ. Well, that is what I am asking.

Senator SHELBY. Yes.

Senator HEINZ. That is what I am asking. Is that a valid criticism?

Senator SHELBY. I think that is not right. This is my—and I draw the analogy here because people vote on us, vote on you, vote on the Senator from North Carolina. Wouldn't it be nice if you could go over the rolls and see who voted for you and who voted against you? It would be interesting.

But why don't we——

Senator HEINZ. I already know in my precinct.

Senator SHELBY. Yes, well, we can tell just about, but you can't tell totally.

But when management knows who is voting for them and who doesn't on the shareholders, the shareholder has no protection there.

Let's go a step further. Let's go in the pension funds and the mutual funds, who owns a lot of the stock. Sure, the pension fund manager, the mutual fund manager, they could give information.

What is wrong with letting information—and I don't know if we would have to amend the statutes if it came to this or not—let the people know how they are voting you and are voting shares in your interest?

And there is a difference between taking the second step and letting management know that and letting the fiduciary know that.

Senator HEINZ. I thought of the same——

Senator SHELBY. There is a difference.

Senator HEINZ. I thought of the same distinction, too. I have the feeling that a well-entrenched corporate management is going to be—is probably going to have a pretty clear idea of what those fiduciaries tell their beneficiaries.

Senator SHELBY. Have a copy of it faxed to them before lunch, huh?

Senator HEINZ. Yes.

Senator SHELBY. Well, they might do that.

Senator HEINZ. I would say to the Senator from Alabama I am sorry to make life so complicated, but that is the way modern technology seems to be making it.

Senator SANFORD. I never have seen the need for confidentiality. I don't know what the corporate management can do to the shareholder that would be harmful. I don't see how that information can be misused. The pressure usually is on the corporate management to petition and implore the big block shareholder not to vote adversely, but they don't really have any leverage in most cases.

I think the advantages of voting openly may remove any perception of unfair counting of votes. Certainly nobody suggests corporations count votes dishonestly unless they want to face a prison sentence, and most votes are counted by CPAs hired for the purpose. I don't really know of a case where the corporation having that information has been able to use it to improperly pressure the shareholder.

I simply don't see this as a crucial issue. I don't mind its discussion, but I never have seen it as an issue.

Senator SHELBY. If it is not an issue, we ought to go ahead and adopt it.

Senator SANFORD. Except it is a highly expensive and complicated kind of a process. I don't know that it would serve a great purpose.

Senator SHELBY. There is a different school of thought out there on that, as you well know.

Senator HEINZ. Yes, there is. There is, and I think, you know, the two of you disagree. I mean, I think it is a jump ball personally, and I think we are all going to have to make our minds up as best we can on it because what seems to be an increasing number of issues, there seem to be good points on both sides.

Gentlemen, I want to thank you for your participation here today. You have been most generous with your time. You have made an invaluable contribution.

I want to make one editorial comment that goes beyond the scope of the legislation.

Personally, I would be much relieved, irrespective of how we dispose of and write this kind of legislation, if there were policies in effect which would have the impact of minimizing management incompetence on an ongoing basis without having to resort to the cataclysmic event of an LBO or an LTO.

I don't know if either of you were here—you may both have been—for the hearing on institutional investors that we had.

I was fascinated by the fact that we had—the manager of the largest private pension fund in the United States, the AT&T pension fund, and I asked him—or maybe Senator Riegle asked him the first question—which was do you pay much attention to the performance of the companies you have in your portfolio?

He said, heavens, no. He said, I got 1200 of them. It is not cost effective for me to look at them. I mean, what I really need to do is kind of buy them in blocks and sell them wholesale, which of course is what index arbitrage and S&P 500 futures are all about.

What that really means is that nobody who owns corporate America today, who manages like that—and that is 50 to 70 percent of all the equity ownership on the American and on the New York Stock Exchanges, pretty big exchanges—is really paying any attention to how the store is being run, and let me tell you that is something I wish we would all think about a little bit.

I thought Ned Regan, who is the Comptroller from New York, New York State, had the right answer. I asked him what he had done about it, and he said, well, we will not invest the State's money in any company that has a majority of inside directors. These companies have got to have a majority of outside directors. My view is hip-hip-hooray. That is pretty good for a start, and what we need are more pension fund managers who will pay attention to some of the fundamentals, like who the heck is running the company, who is holding management accountable, and then maybe we wouldn't have as many tough issues before us if accountability were better established.

Gentlemen, I see Senator Pressler.

Senator SANFORD. I don't want to run off from Senator Pressler, though I have another appointment. I would be glad to hear his opening statement.

Senator HEINZ. Very well, Senator. Thank you for being with us.

Senator Pressler, do you have an opening statement? Any questions?

Senator PRESSLER. Well, Mr. Chairman, I do not have an opening statement. I am here to listen and learn from my colleagues.

Senator HEINZ. We are about to adjourn the hearing. [Laughter.]

Senator Pressler, let the record show that we had a most interesting exchange on a telepathic level.

With that, this hearing is adjourned.

[Whereupon, at 3:20 p.m., the subcommittee was adjourned.]

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